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No. .....

Supreme Court, U.S.
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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

ALIOTO & ALIOTO; HECK & HECK, INC.; HECK OIL, INC.; and MARK ZELEZNY,

Petitioners,

v.

E. F. HUTTON & CO., INC.; KURT FESHBACH; STOCKBRIDGE PARTNERS, INC.; RICHARD JACOBY; HAIM PEKELIS; SHEARSON-AMERICAN EXPRESS, INC.; OPPENHEIMER & CO., INC.; AND DONALDSON, LUFKIN AND JENRETTE SECURITIES CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Did the Ninth Circuit commit reversible error in affirming Fed. R. Civ. P. Rule 11 sanctions against an attorney for failure to interview personally one of two class representatives and to anticipate a potential conflict of interest, where the court never addressed the merits of the complaint filed by that attorney?

2. In failing to address the merits of the complaint, did the Ninth Circuit put itself in conflict with its other opinions on the proper application of Rule 11, thereby impermissibly depriving attorneys of meaningful notice of what conduct violates the Rule?

3. Does the Ninth Circuit's misapplication of Rule 11 in this case have a chilling effect on advocacy, access to the federal courts, and development of the common law?

4. Does the Ninth Circuit's justification of nearly $300,000 in Rule 11 sanctions on the basis that large damages were sought in the challenged complaint chill advocacy and the rights of claimants in large, complex, and difficult cases?

5. Does the Ninth Circuit's affirmance of sanctions in this case defeat Rule 11's deterrent purpose by discouraging prompt corrective action and rewarding satellite litigation?

6. Is the inconsistent application of Rule 11 within and among the circuit courts, as exemplified by the Ninth Circuit's application in this case, a matter of national importance because of the chilling effect on lawyers, claimants, and the law itself?

7. Was it a denial of due process for the Ninth Circuit to dismiss for lack of jurisdiction petitioners' appeal of an award of attorneys' fees and costs under Fed. R. Civ. P. 41(a)(2), because the court held for the first time in this case that such a condition to voluntary dismissal is not appealable legal prejudice?

LIST OF PARTIES

The parties in the proceedings in the U.S. District Court were plaintiffs Unioil, Inc.; Melvin Lloyd Richards; Heck & Heck, Inc.; Heck Oil, Inc.; and Mark Zelezny. Defendants were E. F. Hutton & Co., Inc.; Kurt Feshback; Stockbridge Partners, Inc.; Richard Jacoby; Haim Pekelis; Shearson-American Express, Inc.; Oppenheimer & Co., Inc.; Goldman Sachs & Co; and Donaldson, Lufkin and Jenrette Securities Corporation.

On appeal to U.S. Court of Appeals for the Ninth Circuit, Appellants were Alioto & Alioto; Heck & Heck, Inc.; Heck Oil, Inc.; Mark Zelezny; and Donald Barton.

Plaintiffs Unioil and Richards did not join the appeal to the Ninth Circuit, nor are they petitioners here.

All defendants, except Goldman Sachs & Co., were and are Respondents on appeal to the Ninth Circuit and on this petition to the Supreme Court of the United States.

Petitioners Alioto & Alioto; Heck & Heck, Inc.; and Heck Oil, Inc. are corporations which have no parent companies, subsidiaries, or affiliates to list under Rule 28.1.

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ALIOTO & ALIOTO; HECK & HECK, INC.; HECK OIL, INC.; and MARK ZELEZNY,

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v.

E. F. HUTTON & CO., INC.; KURT FESHBACH; STOCKBRIDGE PARTNERS, INC.; RICHARD JACOBY; HAIM PEKELIS; SHEARSON-AMERICAN EXPRESS, INC.; OPPENHEIMER & CO., INC.; AND DONALDSON, LUFKIN AND JENRETTE SECURITIES CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Petitioners, Alioto & Alioto, Heck & Heck, Inc., Heck Oil, Inc., and Mark Zelezny, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered on October 15, 1986.

OPINIONS BELOW

The opinion of the U.S. Court of Appeals for the Ninth Circuit is reported as modified at 809 F.2d 548 and is reprinted in Appendix A (hereafter "App. A"), pages A-1 to A-16.

The memorandum decisions of the United States District Court for the Central District of California of November 28, 1984 and January 18, 1985, have not been reported and are reprinted in Appendices B and C, pages B-1 to B-11 and C-1 to C-6, respectively (hereafter "App. B" and "App. C").

The Court of Appeals' Order Modifying Opinion and Denying Rehearing is reprinted in Appendix D, pages D1 and D-2 (hereafter "App. D").

JURISDICTION

The Complaint filed on March 21, 1984 in the U.S. District Court for the Central District of California in *Unioil, Inc., at al. vs. E. F. Hutton, et al.* invoked federal jurisdiction under 15 U.S.C. §§ 1 and 15 of the Sherman Act and 15 U.S.C. §§ 78(b) and 78aa of the Securities Exchange Act. After petitioners sought voluntary dismissal of the action on May 24, 1984, the district court ordered sanctions under Rule 11 of the Federal Rules of Civil Procedure against petitioner Alioto & Alioto. Included in the Rule 11 sanctions was an award against petitioners and co-counsel Donald Barton under Rule 41(a)(2).

On appeal to the U.S. Court of Appeals for the Ninth Circuit, the court dismissed the appeal of the Rule 41(a)(2) award for lack of jurisdiction and affirmed the Rule 11 award against petitioner Alioto & Alioto.

The judgment of the United States Court of Appeals for the Ninth Circuit was rendered on October 15, 1986. Petitioners sought a rehearing, which was denied on February 26, 1987. The jurisdiction of this Court to review the judgment of the Ninth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Federal Rules of Civil Procedure, Rule 11. Signing of Pleadings, Motions, and Other Papers; Sanctions.

Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading, motion, or other paper and state his address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney or party consti-

tutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. If a pleading, motion, or other paper is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

Federal Rules of Civil Procedure, Rule 41(a)(2). Voluntary Dismissal; Effect Thereof.

(2) **By Order of Court.** Except as provided in paragraph (1) of this subdivision, an action shall not be dismissed at the plaintiff's instance save upon order of the court and upon such terms and conditions as the court deems proper. If a counterclaim has been pleaded by a defendant prior to the service upon him of the plaintiff's motion to dismiss, the action shall not be dismissed against the defendant's objection unless the counterclaim can remain pending for independent adjudication by the court. Unless otherwise specified in the order, a dismissal under this paragraph is without prejudice.

INTRODUCTION

Since its amendment in August 1983, Rule 11 has been invoked in more than 500 cases. The dramatic increase in Rule 11 awards since its amendment has inspired considerable speculation and concern in the legal community. Although the Rule was intended as a tool to deter the filing of meritless papers in the federal courts, thereby reducing the burden on our congested courts, its use in the last five years has resulted in a disturbing increase in litigation costs, uncertainty about what conduct vio-

lates the Rule, and new burdens on the judicial system in Rule 11 litigation, alone. Furthermore, the recent cases reveal that the courts themselves are unsure about how to apply the Rule. The cases are rife with unwarranted extensions of the Rule, conflicting interpretations, and inconsistent results. The impact upon attorneys is to chill their advocacy and creativity. Worse, the courts' confusing application of the Rule also chills claimants' access to the federal courts to redress injuries. Perhaps most disturbing is the inhibiting effect this chilling process has on the development of our common law.

In petitioner Alioto's case, the Rule was wielded with manifestly disastrous and unjust results. Alioto was sanctioned under Rule 11 in an amount of nearly *$300,000.00* upon seeking *voluntary dismissal of the complaint only two months after it was filed.* The sanctions were awarded despite the fact that the district court *declined repeatedly to address the merits* of the action on which they were based. The district court expressly stated: "... the conduct violative of Rule 11 *does not go to the merits.*" App. B, p. B-7; (emphasis added).

The district court ruled, rather, that "the only conduct found contrary to Rule 11 and subject to sanctions" was the failure of Alioto personally to interview *one* of the named class representatives in the action, whom the court found atypical of the class, and to anticipate from false statements in a newspaper article a conflict of interest in representing Unioil and its shareholders in the same action. The Ninth Circuit affirmed the district court's order in every respect.

In upholding the sanctions, the Ninth Circuit applied the Rule to conduct not governed by it, thereby putting itself in conflict with its own decisions in *Zaldivar v. City of Los Angeles,* 780 F.2d 823 (9th Cir. 1986) and *Golden Eagle Distributing Corp. v. Burroughs,* 801 F.2d 1531 (9th Cir. 1986). The Ninth Circuit's holding illustrates the rampant confusion among all the circuits with regard to the Rule's application and the conduct to be governed by it.

Although the Rule 11 sanctions against Alioto included an award against all the petitioners and co-counsel Barton under Rule 41(a)(2) of $165,774.84, Alioto was ordered to pay the entire amount within 30 days. An astounding $128,366.26 in fees

and costs was awarded to defendants *solely for seeking the sanctions,* themselves.

Astonishingly, the sanctions awarded were *almost doubled* by the fees and costs defendants incurred *on the two motions they filed for sanctions, alone.* Moreover, the litigation on the sanctions themselves took *more than one year.* Thus, application of Rule 11 in this case nearly doubled the legal costs and prolonged the litigation six-fold. Such an anomalous and ironic result is directly contrary to the Rule's deterrent purpose and the Advisory Committee's warning against satellite litigation. In this case, Rule 11 was applied in a fashion which defeats its express goals.

As a final matter, the Ninth Circuit also dismissed petitioners' appeal on the reasonableness of the Rule 41(a)(2) award, *holding for the first time* that an award of attorney's fees and costs did not amount to sufficient legal prejudice to confer appellate jurisdiction on the court. The dismisal was a denial of due process, because petitioners were effectively denied *any* appellate review of this enormous award.

Because the Ninth Circuit's sanctions in the *Unioil* case so far exceeded the scope and purpose of Rule 11, and because confusion reigns among and within the circuits regarding the Rule's use, petitioners respectfully request that this Court grant certiorari under is supervisory powers over the circuits. Petitioners seek: (1) reversal of the Ninth Circuit's decision upholding the Rule 11 sanctions; and (2) review of the Rule 41(a)(2) award or remand to the Ninth Circuit with instructions to review the Rule 41(a)(2) award. Should certiorari be granted, and the court determine that the conduct did fall within the scope of Rule 11, then petitioners seek review of the reasonableness of the Rule 11 sanction. Finally, petitioners respectfully request the Court to establish guidelines as to the intended scope of the Rule, not only to provide uniformity on this critical issue of federal civil procedure, but to forestall the Rule's chilling effect on attorney advocacy and creativity, on claimants' access to their courts, and on the essential evolution of our common law.

STATEMENT OF THE CASE

Unioil is an oil and gas exploration company whose common stock was publicly traded in the national Over The Counter

market. In 1983, Unioil was one of the five top gainers in the Over The Counter market, trading at $13.75 per share by the end of the year. In early February 1984, the price of Unioil's stock plummeted from around $10.00 a share to $2.65 per share. The decline in the stock coincided with publication on February 7, 1984 of a column in *The Wall Street Journal* by R. Foster Winans which insinuated that Unioil was being investigated by the S.E.C., that its stock was grossly over-valued, that statements issued by the company about its production rates were untrue, and that Melvin Lloyd Richards' past history made him suspect. (Mr. Winans was subsequently fired from *The Wall Street Journal* and was convicted and imprisoned for using his column to publish false statements about publicly traded corporations so that his friends and associates could profit from the decline in the price of the stock.)

In the same period of time, Mr. Richards and Thomas Heckenkamp (principal of petitioners Heck & Heck, Inc. and Heck Oil, Inc.) learned through various sources that a number of securities dealers, including the defendants in this action, were making a concerted effort to drive down the price of Unioil's stock through massive short-selling. The NASDAQ Systems Statistics for Unioil also indicated that the trading volume for the months of December, 1983 and January and February, 1984 exceeded the possible number of shares available to be traded. For instance, the report for February alone indicated that 3,891,159 shares, or approximately 86% of the 4,539,226 outstanding shares, were traded. Of that, 1,949,893, or approximately 43% of the outstanding shares were traded the week of February 6 through February 10, 1984, and an additional 898,576, (or 20%), were traded the following week. These numbers appeared even more extraordinary because approximately one-third of the outstanding shares were held by officers or directors or were "restricted" securities and not tradable.

At the same time, defendant Kurt Feshbach, a stockbroker associated with defendant E. F. Hutton, wrote several letters boasting that he was a specialist in "finding out about frauds" and in conducting "bear raids" on companies he considered fraudulent by short-selling their stock. He declared that he was doing so with Unioil stock and that he was advising his clients to do so. He further wrote that he considered Unioil a "two-well" company,

although he also admitted that he could not substantiate these charges.

In late February 1984, Mr. Richards, Mr. Heckenkamp, referring counsel Ed Byles, and Donald Barton, an attorney who had represented Unioil and Richards on past matters, contacted Joseph L. Alioto to discuss the merits of filing a lawsuit against defendants based on accumulated evidence of a conspiracy to manipulate Unioil stock's price. Mr. Richards related during the meeting that, following the decline in the price of Unioil stock, a number of Unioil shareholders had approached him about taking legal action against E. F. Hutton, Feshbach and others. Mr. Heckenkamp was among these, as the Heck companies had sold their Unioil shares at an enormous loss following the dramatic decline in the stock's price.

Mr. Alioto reviewed voluminous documents provided by Messrs. Richards and Heckenkamp, including the NASDAQ statistics, the Winans article, the Feshback correspondence, and Unioil's corporate records regarding the company's financial condition, past performance, and future prospects. Together with the evidence of false and defamatory statements about the company, these documents indicated to Alioto that a concerted scheme by defendants had very likely caused the precipitous decline in the stock's price.

Based on the evidence, and after exploring any possible corporate mismanagement as a cause for the stock's losses, Mr. Alioto advised Messrs. Richards and Heckenkamp that a meritorious action for illegal stock manipulation could be brought on behalf of Unioil as a corporation and Unioil's shareholders as a class. In his opinion, a conspiracy to depress Unioil's stock injured the corporation and shareholders in the same fashion. It was agreed that the Heck companies would act as class representatives of Unioil's shareholders and that Unioil and Richards would sue individually. Mr. Heckenkamp provided a retainer to the Alioto firm. Donald Barton agreed to act as co-counsel to coordinate activities in southern California, where most of the Unioil shareholders resided.

After retaining the Alioto firm, Unioil published a press release announcing that a lawsuit would be filed forthwith and mailed a letter to all Unioil shareholders informing them of the suit and

inquiring if they wanted to join. The company received a large favorable response from shareholders wishing to join the action against the brokers.

The Alioto law firm drafted a complaint alleging violations of federal and state antitrust and securities laws, as well as causes of action under the RICO Act and state common law. In Alioto's view the primary cause of action was to be brought under Section 1 of the Sherman Act, under which existence of the conspiracy and damages were the only necessary elements of proof. Alternatively, he viewed the conspiracy as a fraud-on-the-market case under Section 10(b) of the Securities Exchange Act and Rule 10b-5, under which reliance on the integrity of the market place, rather than subjective reliance, was the important issue.

Shortly before the complaint was to be filed, co-counsel Barton contacted Alioto to request that Mark Zelezny, a Unioil shareholder, be added as a named class plaintiff. Mr. Barton had spoken with Mr. Zelezny, a stock broker, on a number of occasions about Mr. Zelezny's joining the proposed action as a class representative. Mr. Zelezny had purchased thousands of shares of Unioil stock in January and February, 1984, and had sold the stock at a major loss after the stock's sharp decline following *The Wall Street Journal* article. Mr. Barton so informed Mr. Alioto, and based on the evidence of Mr. Zelezny's injury, Mr. Alioto added Mr. Zelezny as a class plaintiff to the lawsuit. The complaint was filed on March 21, 1984.

Upon service of the complaint, defendants filed motions to dismiss under Rule 12(b) of the Federal Rules of Civil Procedure, served requests for documents, and noticed a number of depositions, including the principals of the corporate plaintiffs and Mark Zelezny. The motions to dismiss were never heard by the court.

In mid-April, 1984, three other Unioil shareholder class actions were filed naming Unioil and Richards as defendants and alleging mismanagement as the cause of the decline in Unioil's stock. Upon learning of these actions, the Alioto firm immediately retained independent counsel to obtain an opinion on whether Alioto could continue to represent Unioil and Richards, and the Unioil shareholder class. By May 14, 1984, counsel and clients together had determined that the potential conflict of interest

which had arisen might prevent certification of the class in the *Unioil* action. Mr. Barton notified defendants' counsel on that date of plaintiffs' intent to dismiss the entire action voluntarily in order to resolve the representation issues regarding the class claims. On May 24, 1984, plaintiffs filed a motion for court approval of their voluntary dismissal under Rule 41(a)(2), just two months after the complaint was filed.

Defendants opposed the motion for voluntary dismissal and asked for sanctions under Rule 11. Prior to the hearing on the motion, Unioil and Richards, through newly retained counsel, elected to continue the action against defendants and withdrew from the motion to dismiss.

The motion for voluntary dismissal and requests for sanctions were heard on August 20, 1984. The court granted the motion to dismiss conditionally and awarded defendants Rule 11 sanctions against petitioner Alioto on the ground that Alioto had never personally talked to Zelezny and had failed to predict the shareholder actions filed after the complaint in *Unioil* was filed. No sanctions were ever levied against Unioil or Richards, who continued to litigate the action.

Alioto made a motion to reconsider the sanctions, which was heard and denied on January 14, 1985. The district court ordered further sanctions against the firm under Rule 11 and 28 U.S.C. § 1927 for making the motion. After a determination of defendants' fees and costs by a U.S. Magistrate, the district court entered its final order on June 6, 1985. In the order, the court awarded defendants $294,141.10 in attorney's fees and costs. The Rule 11 sanctions included $165,774.84 in defendants' costs and fees as a condition to the dismissal under Rule 41(a)(2).

The district court awarded the sanctions on the primary ground that Alioto failed to interview class representative Mark Zelezny "when that consultation would or should have readily disclosed that that person's experience was contrary to that about which the class was to complain and that a potential conflict of interest was inherent in undertaking representation of a class action in which one of the named plaintiffs was Unioil." App. B, p. B-7.

The district court found that Mr. Zelezny was an improper class representative under Fed.R.Civ.P. 23(a) because he testified in deposition: that he had not subjectively relied on the

misrepresentations being disseminated about Unioil; that, aware of the short selling, he had purchased rather than sold Unioil stock; and that he thought Unioil was selling at a fair price until February 7, 1984. The court considered Zelezny's testimony important because he was the only named class representative "with an appearance of independence from Unioil." App. B, p. B-8. The court rejected the Heck companies as appropriate class plaintiffs on the basis that they were "closely aligned with Unioil". App. B, p. B-5.

On appeal, the U.S. Court of Appeals for the Ninth Circuit adopted the district court's findings of fact and legal conclusions, and affirmed the Rule 11 sanctions. Of particular importance to the circuit court were the circumstances that:

> (1) Alioto had reason to know that Zelezny was the only named plaintiff with the appearance of independence from Unioil management; (2) Alioto had never previously worked with Barton and knew virtually nothing about him, his experience, or his inquiry into Zelezny's suitability as a class plaintiff; and (3) the Alioto firm is, and represented itself as, experienced and specialized in complex business litigation. (App. A, p. A-12.)

The court declined to consider Alioto's argument that both Zelezny and the Heck companies were proper class representatives in an antitrust or fraud-on-the-market case, deciding that these arguments were not raised in the motion for sanctions.

With regard to petitioners' appeal on the reasonableness of the Rule 41(a)(2) award of fees and costs, the Ninth Circuit held for the first time that a condition of costs and fees does not involve "legal prejudice" sufficient to render such an award adverse and appealable. The court, therefore, dismissed petitioners' appeal for lack of jurisdiction without reviewing the size of the award. App. A, p. A-10.

On Alioto's appeal of the sanctions under Rule 11 and 28 U.S.C. 1927 for filing the motion to reconsider the sanctions, the circuit court did not address the Section 1927 aspect of the award and simply affirmed the Rule 11 award. App. A, p. A-15.

REASONS FOR GRANTING REVIEW

I

THIS CASE PRESENTS AN ISSUE OF NATIONAL IMPORTANCE BECAUSE THE NINTH CIRCUIT'S APPLICATION OF RULE 11 EXEMPLIFIES THE INCONSISTENCY WITHIN AND AMONG THE CIRCUITS, AND ILLUSTRATES THE CHILLING EFFECT THE UNCONTROLLED USE OF THE RULE HAS ON ADVOCACY, ACCESS TO THE COURTS, AND THE EVOLUTION OF OUR COMMON LAW.

A. The Purpose Of Rule 11 Is To Deter The Filing Of Meritless Papers In The Federal Courts

Amended Rule provides in pertinent part:

> The signature of an attorney or party constitutes a certificate by him that he has read the pleading, mortion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law, and that it is not interposed for any improper purpose such as to harass or to cause unnecessary delay or needless increase in the cost of lititgation.

The intent of Rule 11, since its inception, has been to "check abuses in the signing of pleadings" and to curb "dilatory or abusive tactics and help to streamline the litigation process by lessening frivolous claims or defenses." Fed. R. Civ. P. 11, Advisory Committee Notes.[1] The prior rule which applied a

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[1] *See, e.g., Quiros v. Hernandez Colon*, 800 F.2d 1, 3 (1st Cir. 1986) (rule designed to sanction and deter "meritless claims"); *Eastway Const. Corp. v. City of New York*, 762 F.2d 243, 254 (2nd Cir. 1985) (sanctions affirmed where it was "patently clear that . . . claim [had] absolutely no chance of success," and where claim of antitrust violation was "destined to fail"); *Hoover Universal, Inc. v. Brockway IMCO, Inc.*, 809 F.2d 1039, 1044 (4th Cir. 1987) (denial of sanctions upheld where plaintiff had "a glimmer of a chance of prevailing"); *Brown v. Nationwide Mut. Ins., Co.*, 805 F.2d 1242, 1244-45 (5th Cir. 1986) (after being given numerous opportunities "to retreat from pursuing baseless litigation," sanctions upheld where "appellant's counsel should have realized

"good faith" standard, was unsuccessful in this regard. The new language stresses the need "for some prefiling inquiry into both the facts and the law to satisfy the affirmative duty imposed by the rule. The standard is one of reasonableness under the circumstances." *Id.* The reasonableness standard is a more "stringent standard"; nevertheless, "the rule is not intended to chill an attorney's enthusiasm or creativity in pursuing factual or legal theories." *Id.*

In applying Rule 11, the courts must necessarily balance the Rule's goal of deterring meritless filings and the widely recognized duty of an attorney to represent his client creatively and aggressively within the bounds of law. Inherent in the attorney's duty of zealous advocacy is the sound exercise of the attorney's professional judgment. This balance can only be achieved if the federal courts confine their use of Rule 11's sanctioning power to the narrow conduct that is covered by the Rule — the signing of pleadings which are (1) "frivolous" or (2) filed for an improper purpose. Rule 11 is not designed as a cure-all for every phase of civil litigation. It is addressed to papers filed in federal court, at the time they are filed.

In this case, the legal and factual foundation for the pleading Alioto filed was never attacked by either the distrct or the appellate court as frivolous or as filed for an improper purpose. Indeed, the merits of the conspiracy allegations were never

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the hopelessness of her case after it was disposed of on the pleadings"); *Freeman v. Michigan Dept. of State*, 808 F.2d 1174, 1180 (6th Cir. 1987) (sanctions reversed where "plaintiff did not make frivolous [civil rights] claims and her attorney did not act irresponsibly"); *Rodgers v. Lincoln Towing Service, Inc.*, 771 F.2d 194, 205 (7th Cir. 1985) (sanctions affirmed for making "frivolous" and "worthless" claims and filing "a ponderous, extravagant, and overblown [amended] complaint that was largely devoid of a colorable basis"); *Cook v. Peter Kiewit Sons Co.*, 775 F.2d 1030, 1035 (9th Cir. 1985), *cert. denied*, 106 S.Ct. 2919 (1986) (sanctions upheld where lawsuit was "wholly frivolous, insubstantial and groundless"); *Westmoreland v. CBS, Inc.*, 770 F.2d 1168, 1178 (D.C. Cir. 1985) (sanctions upheld where "neither the law nor the facts, as appellee admits them, could have supported appellee's [contempt] petition"); *In Re Oximetrix, Inc.*, 748 F.2d 637, 644 (Fed. Cir. 1984) (sanctions upheld where "there was not even a colorable basis for Oxco's attempted removal . . .").

challenged at all. Rather, Mr. Alioto was severely sanctioned for the exercise of his professional judgment in determining who could properly be included in the lawsuit.

B. The Ninth Circuit's Opinion In *Unioil* Conflicts With Its Opinions In Other Rule 11 Cases Because It Failed To Address The Merits

The Ninth Circuit's decision in the *Unioil* case marks a sharp departure from its pronouncements concerning the scope of Rule 11 in *Zaldivar v. City of Los Angeles*, 780 F.2d 823 (9th Cir. 1986); *Matter of Yagman*, 796 F.2d 1165 (9th Cir.), *reh. denied and amended*, 803 F.2d 1085 (9th Cir. 1986) (See Section C below); and *Golden Eagle Distributing Corp. v. Burroughs Corp.*, 801 F.2d 1531 (9th Cir. 1986).

In *Zaldivar*, 780 F.2d at 829-30, the Ninth Circuit addressed amended Rule 11 for the first time. In discussing the operation of the Rule, the court observed that Rule 11 is not a panacea intended to remedy all manner of attorney misconduct occurring before or during trial:

> Rule 11 applies *to the filing* of a "pleading, motion and other paper" in a civil action .... The certificate [the attorney's signature] is addressed to two separate problems, both of which have been identified as major sources of unnecessary litigation, delay and expense: first, the problem of frivolous filings; and second, the problem of misusing judicial procedures as a weapon for personal or economic harassment. (Emphasis added.)

The court identified the two "prongs" under which a violation might be found as the "frivolousness clause," and the "improper purpose clause," *Id.* at 830-31.

The improper purpose clause was not an issue on appeal to the Ninth Circuit in *Unioil*. The court itself said: "Because Unioil management was not found liable for a Rule 11 violation, we need not assess defendants' allegation that the class claims filed by Alioto were part of the ploy by Unioil management to divert shareholders from suing Unioil and its management." (App. A, p. A-14.) Therefore, the only inquiry in this case should have been whether the paper filed by Alioto was, to the best of his knowledge, information and belief formed after reasonable inquiry,

"frivolous, legally unreasonable or without factual foundation." *Zaldivar*, 780 F.2d 831, (adopting this Court's standard for civil rights cases in *Christianburg Garment Co. v. E.E.O.C.*, 434 U.S. 412, 421-22 (1977)). Instead, the Court focused solely on Alioto's prefiling investigation.

The *Zaldivar* court defined "reasonable inquiry" as follows:

> Such inquiry is that amount of examination into the facts and legal research which is reasonable under the circumstances of the case. 780 F.2d. at 831.

Based on its analysis in *Zaldivar*, the Ninth Circuit erred in imposing sanctions in this case in the absence of a finding that the action filed was frivolous.

Neither the district court nor the Ninth Circuit had any quarrel with the factual or legal bases for the substantive conspiracy allegations for *any* of the plaintiffs in the complaint. Indeed, the district court reiterated this point during the hearing on the motion for sanctions, in the memorandum of decision, and on the motion for reconsideration:

> I want to reiterate, lest there be any mistake about it at all, that at this point *I am making no statement whatsoever with respect to the merits of the substantive allegations which were made nor, indeed, am I making any statement with respect to whether there may have been lurking a class action.* (App. E, p. E-2; emphasis added.)
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> Moreover, in this case even that possibility [premature determination of malicious prosecution] is obviated because *the conduct violative of Rule 11 does not go to the merits.* (App. B, p. B-7; emphasis added.)
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> I think it should also bear repeating or emphasizing that I expressly indicated, both from the bench and in the written order, that *my decision was not intended to and should be taken as having no effect whatsoever on the substantive allegations of the complaint* . . . . (App. F, p. F-2; emphasis added.)

It is clear that the court concluded, *based on the voluntary dismissal,* that the class aspects of the complaint were nonmeritorious when it was filed. In so doing, the court judged the pleading based on circumstances which occurred *after* it was filed and engaged in impermissible "hindsight". Because court disagreed with Alioto that, under Fed. R. Civ. P. 23(a), the Heck companies and Mark Zelezny were proper class representatives in the context of Alioto's primary theories of the case, and because the court apparently determined that Alioto could not properly represent Unioil and its shareholders in the same action, the court applied the Rule as if the action itself were nonmeritorious.

In *Golden Eagle Distributing Co. v. Burroughs Corp.*, 801 F.2d 1531, 1536 (9th Cir. 1986) the Ninth Circuit recognized the damaging effect the amended Rule could have where courts engage in such "Monday-morning quarterbacking":

> This [new standard] gave rise to concerns that the new Rule might have unfortunate results in at least two respects. The first was that the amended Rule might tend to chill creativity in advocacy and impede the traditional ability of the common law to adjust to changing situations. The Advisory Committee responded to this concern by suggesting that courts should not hold a lawyer to a standard measured by what the judge later decides, but should look at the situation which existed when the paper was filed.

The staggering award of sanctions against Alioto was based, not on the merits of the action, but on the *party plaintiffs* he included in the action. As this was a question of professional judgment as to the *form* the action should take, it was not governed by Rule 11. Even if the Rule were intended to encompass an attorney's professional judgment regarding such strategic decisions, which it was not, the Rule does not require an attorney to be right in every instance,[2] it only requires an attorney to proceed reasonably. Under Alioto's view of the case, both factually and legally, he proceeded reasonably in naming the class plaintiffs and in concluding that he could represent Unioil and its shareholders in the same action.

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[2] (*See, Zaldivar*, 780 F.2d at 830, and *Stephens v. Portal Boat Co.*, 781 F.2d 481, 483 (5th Cir. 1986).

The Heck companies and Mark Zelezny were proper class representatives under the antitrust cause of action because all that the class shareholders needed to prove, once the existence of a conspiracy was established, was their damage. *South Carolina Council of Milk Producers v. Newton*, 360 F.2d 414, 420 (9th Cir. 1966). Whether the named class representatives were closely aligned with or totally independent from Unioil was irrelevant to their claims under the antitrust laws. Only a showing that the class plaintiffs were, themselves, participants in the conspiracy could prevent them from being proper class representatives, and there was never any suggestion of this during the case.

Similarly, under Section 10(b) of Securities Exchange Act of 1934, once the conspiracy to commit a fraud on the market was established, the class representatives' subjective reliance was irrelevant, because the class representatives made their stock transactions *in reliance on the integrity of the market. Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975). Thus, both the Heck companies and Mark Zelezny were proper class representatives under Rule 23(a) for the purposes of the securities claim.[3] Alioto's inclusion of these parties was thus clearly warranted by the facts *and* existing law *at the time he filed the complaint.* Nor was the sophistication of the class representative germane to his propriety as a class representative in a conspiracy case like the one at issue here. *McFarland v. Memorex Corp.*, 96 F.R.D. 357, 363 (N.D. Cal. 1982). Likewise, where the complaint alleged stock "transactions," it did not matter whether a class plaintiff purchased or sold his stock, as long as he was injured by the conspiracy when he did one or the other.

The Ninth Circuit also rejected Alioto's argument that he did not interview Mark Zelezny because he relied on co-counsel Donald Barton, who *had* spoken with him, for the evidence of Mr. Zelezny's stock transactions and injury. As the information Bar-

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[3]The Ninth Circuit declined to address this argument on appeal, finding that it was not raised by Alioto on the motion for sanctions. In so ruling, the Ninth Circuit disregarded the fact that in an action alleging conspiracy to manipulate the stock, the requirements for the class representatives were substantially similar, if not identical, under both counts. There is no question that Alioto raised the issue in the context of the antitrust claim.

ton provided was true and sufficient under Alioto's legal theories, to include Zelezny as a class representative, the court erred in finding Alioto's prefiling inquiry inadequate for failure to speak with Zelezny personally. In addition, the court's comment that Alioto did not know Barton, and therefore should not have relied on him, seems to impose a requirement on attorneys to investigate each other under Rule 11, even in the absence of any indication of a need to do so.

The district court's conclusion that the class representatives were not adequate or typical under Rule 23 was premature. This inquiry should have been undertaken in a class certification proceeding, at the conclusion of class discovery and after thoroughly considering the legal basis for their inclusion, not on a motion for Rule 11 sanctions before the principal of the Heck companies — the primary class plaintiff — was even deposed. If, after a proper and full hearing on the legal arguments, the court still believed that the class representatives could not adequately represent the shareholder class, only then, if at all, would it be appropriate to consider whether naming them violated Rule 11.

The second basis for the Ninth Circuit's holding — the potential conflict of interest — is similarly erroneous because it attacked the attorney's reasoning rather than the merits of the pleading he filed, and it punished him for adopting an aggressive posture in seeking to vindicate the rights of *all* those who were injured. In affirming the sanction based on Alioto's failure to predict from *The Wall Street Journal* article that Unioil shareholders would sue Unioil management, the court disregarded the fact that, at the time the pleading was filed, Alioto had sound reason to believe that the interests of the company and its shareholders were in total alignment. This belief followed from the fact that they both sustained the same injury from the conspiracy to depress Unioil's stock *by the brokers*. Alioto was thus justified in concluding that it was unlikely that the shareholders would sue Unioil. Alioto therefore proceeded reasonably in filing an action to protect the rights of both the company and its shareholders, in light of the evidence he examined showing the existence of a conspiracy, and in view of shareholder response to Unioil's invitation to join a suit against the stock brokers. In considering whether sanctions are warranted, all doubts must be

resolved in favor of the signing attorney. *Oliveri v. Thompson,* 803 F.2d 1265, 1275 (2nd Cir. 1986).

Where an action is meritorious legally and factually at the time it is filed, and where there is a valid legal basis for including the class plaintiffs, the fact that a potential conflict materializes later should not subject the attorney to sanctions. This is especially true where the claims could have been asserted in the new shareholder actions or by other lawyers without prejudice to the defendants. The Rule 11 sanctions should be reversed. So, too, should the sanctions on the motion to reconsider. Where the initial sanctions were erroneous, the sanctions on the motion to reconsider must also fail.

C. The Ninth Circuit's Justification Of $300,000 In Sanctions For Two Months Of Litigation On The Basis That The Damages Sought Were Large Chills Advocacy And The Rights Of Claimants In Complex And Difficult Cases

In *Matter of Yagman,* 796 F.2d 1165, 1181 (9th Cir.), *reh. denied and amended,* 803 F.2d 1085 (9th Cir. 1986), the Ninth Circuit observed that a sanction award of $250,000 after two years of litigation and at the end of trial was "a remarkably large monetary sanction — large enough to raise immediate suspicion." The Ninth Circuit accorded no such immediate suspicion to the award against Alioto, however, and, instead, affirmed the sanctions even though Alioto promptly sought to withdraw the action when the representation issue arose. Once again, in so doing, the Court did not even address the merits of the claim.

Moreover, the Ninth Circuit rejected Alioto's argument that, even if sanctions were permissible, the amount imposed against Alioto, alone — $294,141 — was outrageous. The Court characterized Alioto's contention as "nothing more than a blanket charge that the amount of sanctions is patently unreasonable," App. A, p. 16, based on the following justification:

> [T]he class allegations filed by Alioto threatened defendants with massive liability and foreseeably aroused a vigorous and costly defense. Just as the gravity of foreseeable injury is relevant to determining a party's standard of care in a negligence case, so should the cost of a foreseeable response

> by opposing parties be relevant to determining an attorney's standard of reasonable inquiry. (App. A, p. A-12).

This statement by the court suggests that attorneys seeking to vindicate the rights of plaintiffs in large, complex cases are more vulnerable to sanctions than attorneys representing plaintiffs in smaller and simpler cases. The court, therefore, ties the amount of a Rule 11 award to the amount of the damages sought in the complaint.

Under this rationale, attorneys who represent claimants in a large and complicated lawsuit are more vulnerable to sanctions than an attorney in a smaller suit. This use of the Rule is a glaring demonstration of the chilling effect the Rule has upon an attorney's decision to undertake a complex and difficult case, as well as upon the right of parties injured by sophisticated manipulators to seek redress in the federal courts. Where the liability is high, so, too, is the harm to those seeking redress. In such a case, the attorney seeking to right the wrong should not be more at risk merely because of the magnitude of the case.

D. The Ninth Circuit's Decision In *Unioil* Defeats Rule 11's Goal Of Deterrence By Discouraging Prompt Corrective Action And Rewarding Satellite Litigation

The Rule 11 issue arose in this case as a direct result of Alioto's self-initiated attempt to dismiss the action. Petitioners readily acknowledge that an attorney should not be allowed to prosecute a baseless action and dismiss at any time with impunity. Such a rule would indeed encourage rather than deter improper use of the courts. On the other hand, an attorney who discovers a problem which mandates dismissal of a case should not be presented with the dilemma of inviting an award of sanctions or continuing a claim that is no longer properly before the court. This legal conundrum encourages the attorney to delay dismissal and search for a means of obfuscating or circumventing the problem.

Two recent decisions of the Fifth Circuit support petitioners' argument that voluntary dismissal should have obviated sanctions in this case. In *Thomas v. Capital Securities Services, Inc.*, 812 F.2d 984, 988 (5th Cir. 1987) and *Southern Leasing Partners, Ltd. v. McMullan*, 801 F.2d 783, 788 (5th Cir. 1986), the Fifth

Circuit held that an attorney has a duty under Rule 11 to assure that papers he files in federal court continue to be well founded in fact and in law, and if the attorney discovers, after filing a complaint, that the claim is no longer well founded, the attorney must remedy the situation. Although the cited cases disagree as to whether the attorney must actively seek dismissal or simply not oppose a motion to dismiss, it was clearly established in both cases that voluntary dismissal prevents an award of Rule 11 sanctions. *See also Pudlo v. Direction, I.R.S.*, 587 F. Supp. 1010, 1012 (N.D. Ill. 1984), in which the court declined to impose sanctions against an attorney who sought to dismiss claims not legally well-founded, when the applicable law was called to his attention, saying the court was "less inclined to grant awards of attorneys' fees when litigants are that forthcoming and non-obstructionist."

The Ninth Circuit itself has strongly implied that an attorney should be given an opportunity to dismiss a claim without the imposition of sanctions. In *Matter of Yagman*, 796 F.2d 1165 (9th Cir.), *reh. denied and amended*, 803 F.2d 1085 (9th Cir. 1986), the Ninth Circuit stated:

> [I]n situations where a complaint or other paper is obviously and recognizably frivolous when filed, or as circumstances lead the court to strongly suspect that a filed paper may not be well-grounded in fact or law, the court should *at a minimum* provide notice to the certifying attorney that Rule 11 sanctions will be assessed at the end of trial if appropriate. Such early notice in cases of this nature will serve to warn the attorney that he risks incurring substantial sanctions, which will in turn increase the likelihood that meritless claims and motions will be abandoned and additional monetary and judicial resources will be saved. This procedure administers the paramount aim of deterrence and, simultaneously, eliminates the danger of an unsuspected punitive award. *Id.*, 796 F.2d at 1183-84 (emphasis in original).

Thus, under *Yagman*, "at a minimum" courts should warn attorneys that they may be sanctioned in order to *encourage voluntary abandonment* of unmeritorious claims and prevent

unsuspected punishment.[4] In this case, Alioto was hit with an enormous punitive award with absolutely no warning at all.

In affirming the sanctions in this case, the Ninth Circuit also disrgarded the fact that *nearly half* the sanctions *were awarded* to defendants *solely for seeking the sanctions themselves.* Where Rule 11 operates to double the cost of the litigation and prolong the litigation by more than one year, the Rule has lost its effectiveness. The Advisory Committee expressly cautioned courts to avoid "satellite litigation" on Rule 11 awards. To allow the sanctions litigation to drag on for more than one year flies in the face of the Rule's intent. *See Golden Eagle Distributing Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1537 (9th Cir. 1986).

E. The Conflicting, Inconsistent Application Of Rule 11 In The Circuits, Deprives Attorneys Of Meaningful Notice Of What Conduct Will Trigger Liability

Since its amendment, Rule 11 has engendered at least 500 District Court cases on the issue of sanctions. (Rothstein, "Federal Sanctions May Be Hindering Effective Advocacy," *Recorder*, Mar. 16, 1987, at 3.) Prior to the amendments, only 19 such cases were reported. *Id.* Clearly, federal judges have embraced the new Rule enthusiastically.

More alarming than the increase in the *number* of Rule 11 cases, is the inconsistent and, in many cases, unpredictable use the courts have made of the Rule from district court to district court and from circuit to circuit. As a result, federal judges and commentators, alike, have expressed considerable concern about the chilling effect the Rule may have on zealous advocacy of meritorious or borderline claims. S. M. Kassin reported in *An Empirical Study of Rule 11 Sanctions*, (Federal Judicial Center 1985):

> Overall, we found that although the 1983 amendments appear to have increased judges' readiness to enforce the new

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[4]*See also, McLaughlin v. Bradlee*, 803 F.2d 1197, 1205 (D.C. Cir. 1986) and *Brown v. Nationwide Mut. Ins. Co.*, 805 F.2d 1242, 1244 (5th Cir. 1986) where sanctions were awarded only after plaintiff was accorded several opportunities to retreat from pursuing groundless litigation.

> certification requirements, their success thus far has been limited. Of specific concern are the findings that there is a good deal of interjudge disagreement over what actions constitute a violation of the rule, only partial compliance with the desired objective standard, inaccurate and systematically biased normative assumptions about other judges' reactions to frivolous actions, and a continued neglect of alternative nonmonetary means of response. *Id.*

In *Oliveri v. Thompson*, 803 F.2d 1265, 1271 (2nd Cir. 1986), *cert. denied*, 107 S.Ct. 1373 (1987), the Second Circuit observed:

> Even though the subject of sanctions is a distasteful one for any court, increasing tensions in and occasional abuses of the judicial system have prompted both judges and legislators to turn toward sanctions as a means of improving the litigation process. Unfortunately, however, we do not yet have an integrated "code" of sanctions to supply coherent guidance. Indeed, the sources of judges' sanctioning power are diverse, and the standards invoked have not always been either clear or consistently applied.

See also, Nelkin, "Sanctions Under Amended Federal Rule 11 — Some 'Chilling' Problems In The Struggle Between Compensation And Punishment," (hereafter cited as "Nelkin") 74 GEO. L. J. 1313 (1986).

There is also concern that the amended Rule has increased the burden on the courts rather than reduced frivolous or abusive litigation, because sanction litigation has become a new cottage industry in the courts. During a program sponsored by the American Bar Association's Section of Antitrust Law, Judge Edward R. Becker of the Third Circuit stressed that the advantage provided by the use of sanctions is outweighed by the cost to the judicial system, because the threat of sanctions discourages aggressive representation by attorneys, increases the burden on courts, lawyers, and clients, and poisons the litigation atmosphere. 55 U.S.L.W. 2120 (Aug. 26, 1986).

The uneven distribution of sanctions nationwide is also a concern. Judge Becker has noted that roughtly 80% of the sanctions are imposed by only 5% of the judges. *Id.* Other commentators observed during the two years following the amendments that 50% of the sanctions were imposed by judges in

two large metropolitan districts — Manhattan and Chicago — although the caseload in these areas accounted for only 7.8% of federal civil filings. Nelkin, 78 GEO. L. J. at 1326.

Rule 11 cases are necessarily determined on a case-by-case basis. Nevertheless, the federal courts are in considerable disarray on a number of critical issues concerning the Rule, not the least of which is the question of what conduct constitutes a violation. Because the factual circumstances giving rise to sanctions equal, for all practical purposes, the number of cases dealing with sanctions, it must suffice here to offer a telling illustration of the contradictory results courts can reach.

In the Southern District of New York two district judges considered sanctions in cases in which it was found the court lacked subject-matter jurisdiction. In *Grillo v. Harrington, slip op.* no. 85 Civ. 3538 (S.D.N.Y. 1985), discussed in Nelkin, 74 GEO. L. J. at 1329-30 (1986), one judge for the Southern District of New York ordered Rule 11 sanctions against plaintiff and its counsel for filing a complaint in which lack of jurisdiction over political dispute was plain, saying:

> It is clear to anyone with a nodding acquaintance with federal jurisdiction that that issue raises no federal question and no issue cognizable under federal law or the federal constitution, the only bases for the parties — all citizens of New York — to have access to this court. The issue posed . . . is [one] of state law to be adjudicated in the state's courts.

Another judge *in the same district* took a much more permissive attitude and denied sanctions. The court observed:

> It is understandable that litigants will do a small amount of artful conniving to gain access to the diversity jurisdiction of the federal courts, and for a long time such efforts have been tolerated. It is our duty to protect the diversity jurisdiction from abuses of the sort attempted here. In doing so, we need not become punitive. That branch of the motion is denied as a matter of discretion.

Coast Manufacturing Co. v. Keylon, 600 F. Supp. 696, 698 (S.D.N.Y. 1985). *Id. See also, Tarkowski v. County of Lake,* 775

F.2d 173, 175 (7th Cir. 1985) (no sanctions were plaintiff "simply filed in the wrong [federal instead of state] court").

The inconsistencies in the district courts are reflected in the circuit courts' opinions on a number of crucial points. The confusion about the Rule is compounded by the fact that *within* the circuits the results are also inconsistent.

For example, although the amended Rule imposes an *objective reasonableness standard,* some courts still apply the *old bad faith standard* to Rule 11 conduct. *See, Suslick v. Rothschild Securities Corp.,* 741 F.2d 1000, 1007 (7th Cir. 1984), and *McLaughlin v. Bradlee,* 602 F. Supp. 1412, 1417, n.6 (D.C. Cir.), *aff'd,* 803 F.2d 1197 (D.C. Cir. 1986).

Nor do the circuits agree on the *standard of review* in Rule 11 cases. The Third, Fourth, Fifth, and Seventh Circuits have held that a district court's decision to impose sanctions is subject to limited review and will be reversed only for an abuse of discretion. *Lieb. v. Topstone Industries, Inc.,* 788 F.2d 151, 154 (3rd Cir. 1986); *Stevens v. Lawyers Mutual Liability Ins. Co.,* 789 F.2d 1056, 1059 (4th Cir. 1986); *Davis v. Veslan Enterprises,* 765 F.2d 494, 498 (5th Cir. 1985), and *Hilgeford v. Peoples Bank,* 776 F.2d 176, 179 (7th Cir. 1985), *cert. denied,* 106 S.Ct. 1644 (1986). However, the Second Circuit applied a two-tiered approach in *Eastway Construction Corp. v. City of New York,* 762 F.2d 243, 254, n.7 (2nd Cir. 1985), reasoning that the mandatory language of the Rule ("shall impose") divests the courts of discretion where it finds a violation. Discretion is retained only as to the type of sanction to be imposed. Still another approach was taken by the Ninth Circuit in *Zaldivar v. City of Los Angeles,* 780 F.2d 823, 828 (9th Cir. 1986) — factual findings are reviewed under a clearly erroneous standard, the legal conclusion that a violation has occurred is reviewed *de novo,* and appropriateness of the sanction is reviewed for an abuse of discretion.

Although some circuit courts have found that amended Rule 11 *mandates* sanctions where a violation is found, *Eastway Construction Corp. v. City of New York,* 762 F.2d 243, 254, n.7 (2nd Cir. 1985), others have found Rule 11 sanctions to be *discretionary. Lieb v. Topstone Industries, Inc.,* 788 F.2d 151, 158 (3rd Cir. 1986).

As to the question of whether a lawyer's *ethical obligations* are implicated by Rule 11, the Ninth Circuit has held they are not, *Golden Eagle Distributing Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1542 (9th Cir. 1986). In contrast, the Eleventh Circuit holds they are. *Blackwell v. Department of Offender Rehabilitation*, 807 F.2d 914, 915-16 (11th Cir. 1987).

There are also conflicts among and within the circuits on whether or not Rule 11 imposes a *continuing obligation* to refine, modify or withdraw the original pleading or paper *after it is filed*, once the attorney discover grounds to do. No such obligation was found by the Seventh and Second Circuits. *Pantry Queen Foods, Inc. v. Lifschultz Fast Freight, Inc.*, 809 F.2d 451, 454 (7th Cir. 1987) and *Oliveri v. Thompson*, 803 F.2d 1265, 1274 (2nd Cir. 1986), *cert. denied*, 107 S.Ct. 1373 (1987); *but see, Nemeroff v. Abelson*, 704 F.2d 652 (2nd Cir. 1983). On the other hand, the Fifth Circuit has held that an attorney's continuing obligation is one of *four* duties under the Rule. *See* Section I-D above for discussion. The courts who impose such a continuing obligation arguably violate the Advisory Committee's admonition to avoid "hindsight" application of the Rule and, instead, to judge the pleading at the time of signing.

The circuits also disagree on whether an attorney can be sanctioned where a *portion* of the pleading is nonfrivolous. The Ninth Circuit has held that sanctions are inappropriate in such an instance. *Golden Eagle*, 801 F.2d at 1540-41. *But see Unioil v. E. F. Hutton*, 809 F.2d 548 (9th Cir. 1986) (sanctions upheld on "class claims" where "substantive" allegations not challenged.) The First, Second, and Seventh Circuits, however, have upheld sanctions against attorneys for including frivolous claims or arguments in papers found otherwise to be meritorious. *Quiros v. Hernandez Colon*, 800 F.2d 1, 2-3, (1st Cir. 1986); *Oliveri v. Thompson*, 803 F.2d 1265, 1280 (2nd Cir. 1986), *cert den.*, 107 S.Ct. 1373 (1987) (suggesting that "boilerplate" claims are sanctionable in an otherwise meritorious pleading); *Rodgers v. Lincoln Towing Co.*, 771 F.2d 194, 205 (7th Cir. 1985) (imposing only one-third of the fees and costs incurred in defending, "thereby crediting the possible merit of some of Rodger's claims . . . ").

Although courts must consider the facts and the law governing each case in reaching a determination, the extraordinary range in scope and severity in the courts' use of sanctions prevents attorneys from having any meaningful notice of what activity may subject them to liability under Rule 11. This, in turn, leads to a circumstance where an attorney's advocacy and creativity are chilled. The uncertainty surrounding the application of the Rule may discourage lawyers from taking cases where the law is unsettled or where the cause is unpopular. Where an attorney's fear of sanctions motivates his decision of whether or not to take a case, the Rule has an impermissible chilling effect on the attorney's ability to represent his clients effectively. Likewise, this chilling effect inhibits claimants' access to the federal courts, especially where their causes may depend on modifying or changing the law, or where their rights are not initially provable and require factual development during discovery.

Lastly, the vitality of the common law depends on its ability to adopt to changing societal conditions. Attorneys have played an essential role in bringing about these changes. The courts' sanctioning power must be applied evenhandedly if the bar is to continue its role in changing and revitalizing our law without fear of sudden, unforeseen retribution.

The court for the Second Circuit expressed the concept as follows:

> In framing this standard . . . we do not intend to stifle the enthusiasm or chill the creativity that is the very lifeblood of the law. Vital changes have been wrought by those members of the bar who have dared to challenge the received wisdom, and a rule that penalized such innovation and industry would run counter to our notions of the common law itself.

Eastway Construction Corp. v. City of New York, 762 F.2d 243, 254 (2nd Cir. 1985).

This Court has the power to review the application of Rule 11 in this case and to set forth guidelines for the uniform administration of the Rule by the federal courts. *Schlagenhauf v. Holder*, 379 U.S. 104, 112 (1964). Because the Rule was applied so unjustly in this case, and with such a chilling effect, petitioners respectfully request this Court to review on certiorari the Rule 11

award against petitioner Alioto and to reverse the sanctions imposed against him.

II

THE FAILURE OF THE NINTH CIRCUIT TO CONSIDER THE REASONABLENESS OF THE RULE 41(a)(2) AWARD FOR LACK OF JURISDICTION WAS A DENIAL OF DUE PROCESS.

Because the Ninth Circuit held for the first time in the *Unioil* case that attorneys fees and costs awarded under Rule 41(a)(2) do not amount to "legal prejudice," the court dismissed that portion of the appeal for lack of jurisdiction. (App. A, p. A-10). By holding retroactively that the award was not appealable, the Ninth Circuit effectively deprived petitioners of any review at all.

Since the Ninth Circuit had not addressed this issue before the *Unioil* case, petitioners justifiably relied on the holdings of the Fifth and District of Columbia Circuits in *G.A.F. Corp. v. Transamerica Insurance Co.*, 665 F.2d 364 (D.C. Cir. 1981); *McLaughin v. Cheshire*, 676 F.2d 855 (D.C. Cir. 1982); and *Yoffe v. Keller Industries, Inc.*, 582 F.2d 982 (5th Cir. 1978), *cert. denied*, 440 U.S. 915 (1979), all of which entertained an appeal of fees and costs awarded under Rule 41(a)(2).

Not only does the Ninth Circuit's holding in this case conflict with the above circuit court decisions, it also reaches a contrary result to its opinions in *Coursen v. A.H. Robbins Co.*, 764 F.2d 1329, 1343 (9th Cir.), *corrected*, 773 F.2d 1049 (9th Cir. 1985), and *Williams v. Boeing Company*, 681 F.2d 615 (9th Cir. 1982), in which the court expressly declined to allow the result that appellants were denied any appellate review.

Review of the reasonableness of the 41(a)(2) award of $165,774.84 is especially critical in light of the brevity of the litigation on the class claims, and in light of the fact that *the litigation continued* with Unioil and Richards as plaintiffs after the class claims were withdrawn. Rule 41(a)(2) is not designed as a fee-shifting mechanism. It is intended to protect defendants from having to *re*litigate an action *based on a new filing*, not to compensate them for work they would have had to do in any event. The Rule is directed at "duplicative legal expenses" created by *subsequent litigation*. *Cauley v. Wilson*, 754 F.2d 769, 772

(7th Cir. 1985). Because Unioil and Richards continued the action individually, most, if not all, of the work done by defendants was useful. Since the Ninth Circuit's dismissal of the appeal for lack of jurisdiction without considering these issues denies any appellate review to petitioners on the Rule 41(a)(2) award, petitioners have been denied due process.

CONCLUSION

For the foregoing reasons, it is respectfully requested that this Court grant this Petition for a Writ of Certiorari in order to review the Rule 11 award against petitioner Alioto and the Rule 41(a)(2) award against all petitioners. Thereafter, the Supreme Court should reverse the Rule 11 award, review or remand for review the Rule 41(a)(2) award, and promulgate guidelines for uniform application of Rule 11 in the future.

Dated: May 22, 1987

Respectfully submitted,

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Appendix A

UNIOIL, INC., et al., Plaintiffs,

and

Heck Oil, Inc.; Heck & Heck, Inc.;
and Mark Zelezny,
Plaintiffs-Appellants,

v.

E.F. HUTTON & CO., INC.; Kurt Feshback; Stockbridge Partners, Inc.; Richard Jacoby; Haim Pekelis; Shearson-American Express, Inc.; and Goldman Sachs & Co.; and Donaldson, Lufkin & Jenrette Securities Corp.,
Defendants-Appellees.

No. 85-6024.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted June 3, 1986.

Decided Oct. 15, 1986.

Appeal from the United States District Court for the Central District of California.

Before WALLACE, FARRIS, and CANBY, Circuit Judges.

OPINION

WALLACE, Circuit Judge:

Heck & Heck, Inc. and Heck Oil, Inc. (the Heck companies) and Zelezny, along with their counsel, Joseph L. Alioto (Alioto) of the firm of Alioto & Alioto, and Donald Barton (Barton) of the firm of Donaldson & Barton, appeal from the district court's order granting their motion under rule 41(a)(2), Fed.R.Civ.P., for voluntary dismissal of their claims on condition that they reimburse the defendants $165,774.84 in expenses and attorneys' fees. Alioto appeals from the district court's order imposing sanctions against him for violations of rule 11, Fed.R.Civ.P., in the amount of $294,141.10. We dismiss the appeal from the rule 41(a)(2)

order for lack of appellate jurisdiction. We have jurisdiction pursuant to 28 U.S.C. § 1291 over Alioto's appeal from the rule 11 sanctions, and we affirm.

Unioil, Inc. (Unioil) is a company engaged in oil and gas exploration and production. During 1983, the price of Unioil's publicly traded stock soared from $1.25 per share early in the year to $13.75 per share in mid-December. At the beginning of February 1984, the stock was trading around $10 per share.

In early February 1984, Unioil's stock sharply declined. On February 7, the Wall Street Journal published an article reporting that several professional investors were selling Unioil stock "short" (i.e., were selling for future delivery stock that they did not yet own) in the belief that it was overvalued. The article stated that some of Unioil's public announcements had proven to be too optimistic. It also disclosed that Unioil's chairman of the board of directors, Richards, had twice previously been cited by the Securities and Exchange Commission for making false and misleading statements. In the days following publication of this article, Unioil stock further plummeted to $2.625 per share.

On March 21, 1984, Unioil, Richards, the Heck companies and Zelezny, filed a complaint in district court. The Heck companies owned large blocks of Unioil shares. Zelezny, a stockbroker, also owned Unioil shares. In addition, the named plaintiffs purported to be representatives of a class of all other Unioil shareholders. Alioto and Barton acted jointly as counsel for all plaintiffs. They sued several brokerage houses and individuals (the defendants), alleging a concerted scheme to sell Unioil stock short in violation of federal antitrust and securities laws, RICO, and various California laws. The complaint further alleged that the defendants had defamed Unioil and Richards.

The role of Zelezny in this purported class action litigation merits special focus. Since the Heck companies were major shareholders of Unioil and appeared to be closely aligned with Unioil management including Richards, Zelezny was the only named plaintiff with the appearance of independence from Unioil leadership. Zelezny had his first contact with this litigation when Barton, the referring co-counsel, approached him in February

1984 about the alleged market manipulation of Unioil stock. Barton, not Zelezny, first raised the subject of Zelezny's becoming a named plaintiff in the case.

Zelezny had not yet agreed to become a named plaintiff when Unioil announced in late February 1984 that it and a group of its shareholders had retained Alioto to institute a class action alleging market manipulation of Unioil stock. Alioto never spoke with Zelezny prior to filing the complaint, nor did he inquire whether Barton had investigated Zelezny's suitability as a named plaintiff in the purported class action. Alioto learned from Barton only that Zelezny had sold Unioil stock the day after the Wall Street Journal article appeared.

On May 3, 1984, the defendants commenced a deposition of Zelezny. The following day, Zelezny failed to appear for the continuation of his deposition. Instead, Barton announced that Zelezny had decided to withdraw as a named plaintiff and would not appear for further deposition questioning. The defendants then obtained a magistrate's order requiring Zelezny to complete his depositon. Zelezny appeared for three more days of testimony. Zelezny's deposition testimony was, in the judgment of the district court, "in many critical respects contrary to the allegations of the complaint": (1) whereas the complaint alleged that defendants' short selling and fraudulent misrepresentations drove the price of Unioil stock down and caused shareholders to sell at a loss, Zelezny testified that, aware that short selling was occurring, he purchased rather than sold Unioil shares in the belief that the price of the shares would eventually be driven up when the short sellers had to cover; (2) whereas the complaint alleged that plaintiffs sold Unioil shares at artificially depressed prices between December 1, 1983 and February 29, 1984, Zelezny testified that he thought that Unioil was selling at a fair price until February 7, 1984; and (3) whereas the complaint alleged that plaintiffs engaged in stock transactions based on false statements by defendants, Zelezny testified that he never bought or sold Unioil stock in reliance on anything said by any of the defendants.

On May 14, one day before Zelezny's deposition was to resume again, Barton announced that Zelezny would not appear, that neither plaintiffs nor their attorneys would appear for any further

depositions, and that plaintiffs would voluntarily dismiss their complaint. On May 15, 1984, plaintiffs filed a notice purporting to dismiss their entire action without prejudice pursuant to Fed.R.Civ.P. 41(a)(1). One defendant objected to the notice on the ground that dismissal of an alleged class action requires court approval under rules 23(e) and 41(a)(1), Fed.R.Civ.P. Plaintiffs then moved pursuant to rule 41(a)(2), Fed.R.Civ.P., for a court order approving the dismissal of their action without predjudice. In support of their motion, plaintiffs cited three Unioil shareholder class actions that had been filed against Unioil and Richards in mid-April 1984. These actions named Unioil and Richards as defendants and alleged that mismanagement was the cause of the decline in the price of Unioil stock. Perceiving that Alioto and Barton would face a conflict of interest in representing both Unioil and the class of Unioil shareholders, plaintiffs stated their desire not to assert claims on behalf of the shareholder class.

In response to plaintiffs' rule 41(a)(2) motion, defendants asked the district court to require, as a condition of any dismissal without predjudice, that plaintiffs and their counsel pay defendants' attorneys' fees and costs incurred in the action. Pursuant to Fed.R.Civ.P. 11, defendants further sought sanctions of attorneys' fees and costs against plaintiffs' counsel on the grounds that plaintiffs' counsel undertook representation of plaintiffs with conflicting interests and failed to conduct a reasonable inquiry into the factual basis of the complaint. At this juncture, Unioil and Richards, through newly retained counsel, withdrew their motion for court approval of dismissal of their claims.

In November 1984, the district court entered an order granting the motion of the Heck companies and Zelezny for dismissal without predjudice of their individual and class claims *on condition that* these plaintiffs and/or their counsel—Alioto and Barton—"reimburse defendants for their costs and expenses, including attorneys' fees, reasonably incurred in defending against the class action claims." The district court imposed another condition that is not at issue on this appeal.

The district court also imposed rule 11 sanctions of attorneys' fees and costs against Alioto. The court held that Alioto's conduct had violated rule 11 in three respects: (1) Alioto did not conduct

a reasonable investigation into the facts upon which the class allegations were made or into the potential conflict of interest that was inherent in undertaking representation of the class of Unioil shareholders in an action in which Unioil was one of the named plaintiffs; (2) Alioto tried to disengage from class discovery without cause and from the class action suit without court approval; (3) Alioto submitted declarations, in opposition to defendants' motions, that plainly did not comport with the requirements for statements under oath.

Alioto then moved the court to reconsider its order on the ground that the court had failed to consider material facts that had been brought to its attention. In an order dated January 14, 1985, the district judge found that Alioto's arguments were without basis and were made in bad faith. She therefore ordered that Alioto be further sanctioned under rule 11 in the amount of attorneys' fees and costs reasonably incurred by defendants in opposing the motion to reconsider.

The district court referred the determination of the amount of attorneys' fees and costs on the rule 41(a)(2) condition and under the rule 11 sanctions to a magistrate. In an order entered in June 1985, the district court confirmed the magistrate's recommendation that plaintiffs' voluntary dismissal without prejudice of their class action claims be conditioned on the payment by the Heck companies, Zelezny, Alioto, or Barton of $165,774.84 to defendants. The court further confirmed that the rule 11 sanctions required Alioto to pay to defendants within thirty days $294,141.10, such amount to be reduced by any reimbursement received by defendants during that period under the rule 41(a)(2) condition.

In an order entered in March 1986, the district court dismissed Unioil's and Richards' individual claims with prejudice for failure to prosecute. Unioil and Richards are not parties to this appeal.

II

The Heck companies, Zelezny, Alioto, and Barton purport to appeal from the district court's rule 41(a)(2) order conditioning the dismissal without prejudice of their claims on the reimburse-

ment to defendants of costs and attorneys' fees in the amount of $165,774.84. While no party raises the issue, we must address sua sponte whether we have jurisdiction over this appeal. *See Baumann v. Arizona Department of Corrections*, 754 F.2d 841, 843 (9th Cir.1985).

We may readily reject one seeming jurisdictional defect—the fact that the order appealed from is interlocutory in that it was entered at a time when the claims of Unioil and Richards remained to be decided by the district court. Absent a certificate under Fed.R.Civ.P. 54(b), such an order is generally not appealable. In *Anderson v. Allstate Insurance Co.*, 630 F.2d 677 (9th Cir.1980) (*Allstate*), however, we described an exception to the finality rule: we held that we may treat an interlocutory order as a final order when that portion of the case that remained in the district court has subsequently been terminated. *Id.* at 680-81. Because Unioil's and Richards' claims have since been dismissed with prejudice, we may, under *Allstate*, disregard the fact that they previously rendered the district court's order interlocutory.

This, however, is not the end of our jurisdictional inquiry, for a far more troubling difficulty besets this appeal. Rule 41(a)(2), governing voluntary dismissal by court order, provides in part: "Except as provided in [rule 41(a)(1)], an action shall not be dismissed at the plaintiff's instance save upon order of the court and upon such terms and conditions as the court deems proper." Fed.R.Civ.P. 41(a)(2). As we explained recently in *Lau v. Glendora Unified School District*, 792 F.2d 929 (9th Cir.1986) (per curiam) (*Lau*), an order granting a conditional voluntary dismissal does not take effect of its own force. *Id.* at 930. Rather, the plaintiff has "a reasonable period of time within which [either] to refuse the conditional voluntary dismissal by withdrawing [the] motion for dismissal or to accept the dismissal despite the imposition of conditions." *Id.* at 931.

Here, the Heck companies and Zelezny have neither withdrawn their motions for voluntary dismissal under rule 41(a)(2) nor expressly accepted the conditional voluntary dismissal. Three courses of action present themselves. First, we could conclude that the failure expressly to accept the conditional voluntary dismissal renders it inoperative. If so, their claims survive in the

district court, the order from which they and counsel appeal is interlocutory, and we are without jurisdiction. Second, we could determine that by not withdrawing their motions for voluntary dismissal within a reasonable time, the Heck companies and Zelezny must be deemed to have accepted the conditional voluntary dismissal. Under this approach, the district court's order would be final. Third, as we did in *Lau*, 792 F.2d at 930, we could remand this case to the district court in order that they could clearly choose either to withdraw their motions for voluntary dismissal or to accept the conditional voluntary dismissal.

We cannot pursue the first course of action. *Lau* makes clear that a plaintiff must affirmatively act to withdraw a motion for voluntary dismissal. To construe inaction as rejection of a conditional voluntary dismissal would conflict with *Lau*.

We are left to choose between our second and third courses of action. Significantly, *Lau* in no way indicates that we should always remand when a plaintiff has neither withdrawn the motion for voluntary dismissal nor accepted the conditional voluntary dismissal. On the contrary, *Lau* expressly left open "whether a plaintiff who fails to withdraw the motion for dismissal [may] be regarded as having consented to the conditions attached." 792 F.2d at 931. We merely deemed remand "appropriate under [the] circumstances," as we observed both that the district court had not expressly granted plaintiff the option of withdrawing her motion for voluntary dismissal and that we had not previously held that plaintiffs should be made aware of such an option. *Id.* We therefore read *Lau* to hold that remand may be appropriate where a plaintiff neither knew nor had reason to know of the option of withdrawing the motion for voluntary dismissal.

Unlike the plaintiff in *Lau*, the Heck companies and Zelezny were plainly aware of their option to withdraw the motion for voluntary dismissal. In their reply memorandum opposing defendants' request for rule 41(a)(2) conditions, they explicitly spelled out this option, citing as authority the very District of Columbia Circuit case that *Lau* follows. Under these circumstances, a remand to the district court would be pointless.

Deciding a question left open by *Lau*, we therefore hold that a plaintiff who knows or has reason to know that he may withdraw his motion for dismissal will be deemed to have consented to the conditions attached to the voluntary dismissal unless he withdraws his motion within a reasonable time. The Heck companies and Zelezny have not withdrawn their motions within a reasonable time, but have instead pursued an appeal. It follows that they must be deemed to have accepted the district court's conditional voluntary dismissal. Therefore, the rule 41(a)(2) order from which they and counsel appeal is final order.

That the order granting the conditional voluntary dismissal is final, however, does not alone mean that we have jurisdiction. To be appealable, an order must be adverse to the appealing party. As a general rule, a plaintiff may not appeal a voluntary dismissal because it is not an involuntary adverse judgment against him. *Wickland Oil Terminals v. Asarco, Inc.*, 792 F.2d 887, 893 (9th Cir.1986); *Seidman v. City of Berverly Hills*, 785 F.2d 1447, 1448 (9th Cir.1986) (per curiam).

The circuits have provided a range of answers to the question whether this general rule applies to a conditional voluntary dismissal. The Sixth Circuit has held that conditional voluntary dismissals are not appealable, since the palintiff has agreed to the order, even if with reluctance. *Scholl v. Felmont Oil Corp.*, 327 F.2d 697, 700 (6th Cir.1964); *see also* 9 C. Wright & A. Miller, *Federal Practice & Procedure* § 2376, at 247.

In *LeCompte v. Mr. Chip, Inc.*, 528 F.2d 601 (5th Cir.1976) (*LeCompte*), the Fifth Circuit adopted an intermediate position, holding that a plaintiff can appeal a rule 41(a)(2) conditional dismissal that "involves prejudice in a legal sense." *Id.* at 604. In *LeCompte*, the trial court, while denominating its order a dismissal without prejudice, *id.* at 603, had imposed rule 41(a)(2) conditions that "severely circumscribed [plaintiff's] freedom to bring a later suit." *Id.* at 604; *see id.* at 602 (conditions included requirement that any subsequent suit be brought in same court and only upon showing of extraordinary circumstances). The Fifth Circuit distinguished

> the usual conditions attached to a voluntary dismissal [, which] involve prejudice only in a practical sense (*e.g.*, paying costs or expenses, producing documents, producing witnesses). The imposition of this type condition does not amount to the type of "legal prejudice" which would entitle a plaintiff to appeal the grant of the dismissal he obtains.

Id. at 603; *see also Yoffe v. Keller Industries, Inc.*, 580 F.2d 126, 129-31 (5th Cir. 1978) *(Yoffe), cert. denied,* 440 U.S. 915, 99 S.Ct. 1231, 59 L.Ed.2d 464 (1979).

The Seventh Circuit is most expansive in its view of appellate jurisdiction over voluntary conditional dismissals. In *Cauley v. Wilson,* 754 F.2d 769, 770-71 (7th Cir.1985), the Seventh Circuit held that it had jurisdiciton of voluntary dismissals conditioned on payment of fees, "at least in cases in which a plaintiff requests a dismissal in order to proceed in state court." *Id.* at 771; *see also id.* at 770-71 (suggesting, arguably erroneously, that the District of Columbia Circuit has held that it has jurisdiction over appeals of voluntary dismissals conditioned on payment of fees).

We spoke on the issue in *Coursen v. A.H. Robins Co.*, 764 F.2d 1329 (9th Cir.) *(Coursen), corrected,* 773 F.2d 1049 (9th Cir.1985), where we held that a dismissal with prejudice was appealable, whether voluntary or involuntary. 764 F.2d at 1342-43, *corrected,* 773 F.2d at 1049. In the course of so holding, we stated, "A plaintiff may appeal a voluntary dismissal which imposes a condition that creates sufficient prejudice in a legal sense." 764 F.2d at 1342. We cited *LeCompte* as authority for this proposition, and also cited, with a *see also* signal, a case involving involuntary dismissal, *Gardiner v. A.H. Robins Co.*, 747 F.2d 1180, 1186-87 (8th Cir.1984). *Coursen,* 764 F.2d at 1342-43.

Accepting the statement in *Coursen* that a plaintiff may appeal a conditional voluntary dismissal that imposes sufficient legal prejudice, we must determine whether the condition of costs and attorneys' fees imposed on the rule 41(a)(2) order in this case renders the order appealable. We find it especially significant that our statement in *Coursen* is supported by a citation to the Fifth Circuit's opinion in *LeCompte,* rather than to its more recent opinion in *Yoffe. Le Compte* differs form *Yoffe* in at least one

important respect: whereas *LeCompte* holds that a "usual" rule 41(a)(2) condition, such as "payment of costs and attorneys' fees," does not involve legal prejudice, 528 F.2d at 603, *Yoffe* indicates that a condition imposing a "clearly unreasonable" amount of costs and fees may amount to appealable legal prejudice. 580 F.2d at 131. Thus, consistent with *Coursen* and *LeCompte,* we hold that a condition of costs and attorneys' fees does not involve legal prejudice and therefore does not render a conditional voluntary dismissal adverse and appealable. In so holding, we in no way intend to suggest that we find the amount of costs and fees in this case clearly unreasonable. Nor do we foreclose the possibility that review of clearly unreasonable conditions could be obtained through a writ of madamus.

Because the condition of costs and attorneys' fees that plaintiffs and counsel challenge does not involve legal prejudice, it is not adverse, and we have no jurisdiction over this appeal. We therefore dismiss the appeal of the rule 41(a)(2) order.

III

Alioto challenges on several grounds the district court's imposition of rule 11 sanctions against him. The jurisdictional defect that precludes our review of the district court's rule 41(a)(2) order does not apply to Alioto's rule 11 appeal, since the court's imposition of sanctions is plainly adverse to him. An order imposing sanctions solely upon counsel, a non-party to the underlying action, is immediately appealable as a final order. *Optyl Eyewear Fashion International Corp. v. Style Companies, Ltd.,* 760 F.2d 1045, 1047 n. 1 (9th Cir.1985); *Kordich v. Marine Clerks Association,* 715 F.2d 1392, 1393 (9th Cir.1983).

Rule 11, as amended in 1983, states in part:

> Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record in his individual name . . . The signature of an attorney . . . constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by

> existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . . If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

Fed.R.Civ.P. 11. A violation of rule 11 need not be premised on a finding of subjective bad faith. *Zaldivar v. City of Los Angeles*, 780 F.2d 823, 829 (9th Cir.1986) (*Zaldivar*). Rather, an attorney violates rule 11 whenever he signs a pleading, motion, or other paper without having conducted a *reasonable inquiry* into whether his paper is frivolous, legally unreasonable, or without factual foundation. *Id.* at 830-31. An attorney also violates rule 11 whenever he signs a paper that is filed for a purpose that is improper under an objective standard. *Id.* at 831 & n. 9.

In *Zaldivar*, we set forth the following standards of review for orders imposing rule 11 sanctions:

> If the facts relied upon by the district court to establish a violation of the Rule are disputed on appeal, we review the factual determinations of the district court under a clearly erroneous standard. If the legal conclusion of the district court that the facts constitute a violation of the Rule is disputed, we review that legal conclusion *de novo*. Finally, if the appropriateness of the sanctions imposed is challenged, we review the sanction under an abuse of discretion standard.

Id. at 828 (footnote omitted).

A.

The primary ground—indeed, according to Alioto's reply brief, the sole ground—upon which the district judge imposed rule 11

sanctions in her November 1984 order was that Alioto had failed to conduct a reasonable inquiry into the facts upon which the class allegations in the complaint were based and into the potential conflict of interest inherent in representing a class of Unioil shareholders while at the same time representing Unioil and Richards.

Whether Alioto's inquiry was reasonable must be determined in light of the circumstances in which he acted. *See* Fed.R.Civ.P. 11 advisory committee note ("The standard is one of reasonableness under the circumstances."). From factual findings of the district court that Alioto has not shown to be clearly erroneous, we conclude that the relevant circumstances include (1) that Alioto had reason to know that Zelezny was the only named plaintiff with the appearance of independence from Unioil and its management; (2) that Alioto had never previously worked with Barton and knew virtually nothing about him, his experience, or his inquiry into Zelezny's suitability as a class plaintiff; and (3) that the Alioto firm is, and represented itself as, experienced and specialized in complex business litigation. There was a substantial retainer paid to Alioto and there was ample time for investigation and, therefore, there were no severe constraints of time or money that impeded Alioto's inquiry. Finally, we consider it significant that the class allegations filed by Alioto threatened defendants with massive liability and foreseeably aroused a vigorous and costly defense. Just as the gravity of foreseeable injury is relevant to determining a party's standard of care in a negligence case, so should the cost of a foreseeable response by opposing parties be relevant to determining an attorney's standard of reasonable inquiry.

We now consider whether Alioto conducted a reasonable inquiry into the facts upon which the class allegations were based. Alioto does not dispute the district court's findings that he never spoke with Zelezny prior to filing the complaint and that he never asked of, or learned from, Barton information bearing on whether Zelezny was a sophisticated investor, whether Zelezny had relied upon any of the defendants' representations, and whether Zelezny would fairly and adequately represent the class. According to a finding of fact that we do not find clearly erroneous, Alioto knew

only that Zelezny had sold Unioil stock the day after the *Wall Street Journal* article was published. We agree with the district court that, aware of this fact alone, Alioto has no reasonable basis for determining that Zelezny's "claims or defenses [were] typical of the claims or defenses of the class," Fed.R.Civ.P. 23(a)(3), or that Zelezny would "fairly and adequately protect the interests of the class," Fed.R.Civ.P. 23(a)(4).

Alioto offers three basic arguments to support his contention that he did not violate rule 11. First, he argues that his reliance on Barton satisfied the requirement of reasonable inquiry. We agree that reliance on forwarding co-counsel may in certain circumstances satisfy an attorney's duty of reasonable inquiry. *See* Fed.R.Civ.P. 11 advisory committee note. In relying on another lawyer, however, counsel must "acquired[ ] knowledge of facts sufficient to enable him to certify that the paper is well-grounded in fact." Schwarzer, *Sanctions Under the New Federal Rule 11—A Closer Look*, 104 F.R.D. 181, 187 (1985). An attorney who signs the pleading cannot simply delegate to forwarding co-counsel his duty of reasonable inquiry. *Id.*

Second, Alioto appears to argue that he did not violate rule 11 since Zelezny was in fact a proper class plaintiff. The core of Alioto's argument is that Zelezny's lack of reliance on defendants' alleged misrepresentations is irrelevant to his viability as a class representative since, under *Blackie v. Barrack*, 524 F.2d 891 (9th Cir.1975), *cert. denied*, 429 U.S. 816, 97 S.Ct. 57, 50 L.Ed.2d 75 (1976), proof of subjective reliance is unnecessary to establish a rule 10b-5 claim. *But see, e.g., Lewis v. Johnson*, 92 F.R.D. 758, 759-60 & n. 1 (E.D.N.Y.1981) (even though class action plaintiffs need not prove reliance in a securities fraud case, certification must be denied when the putative class plaintiff is subject to atypical reliance and materiality defenses that might prejudice the class' chances of success). Alioto did not make this argument as a defense to the imposition of rule 11 sanctions in the district court and has provided us with no reasons for his failure to do so. Therefore, because we believe that no manifest injustice will result if we decline to consider the issue, we will not address it here. *See Alexopulos v. Riles*, 784 F.2d 1408, 1411 (9th Cir.1986).

Third, Alioto argues that the Heck companies were proper class plaintiffs and that we must give substantial weight to his investigation into their claims in deciding whether his inquiry into the facts underlying the class allegations was reasonable. We disagree. Alioto had reason to know that the Heck companies appeared to be closely aligned with Unioil and its management. The district court did not err in determining that a reasonably competent business attorney should have realized, upon reading the *Wall Street Journal* article, the strong possibility that Unioil shareholders would sue Unioil management. Under these circumstances, Alioto had a duty to take reasonable steps to ensure that the class claims were represented by a plaintiff independent of Unioil management and otherwise qualified under rule 23(a). Alioto took no such steps.

We therefore hold that the district court did not err in concluding that Alioto violated rule 11 by not making a reasonable inquiry into the facts on which the class allegations of the complaint were based. For similar reasons, we affirm the district court's conclusion that Alioto failed to conduct a reasonable inquiry into the potential conflict of interest inherent in representing a class of Unioil shareholders together with Unioil and Richards. As we just stated, the district court properly found that a reasonably competent business attorney should have recognized from the beginning the clear likelihood that Unioil shareholders would bring suit against Unioil management. We focus only on the duty Alioto had to conduct a reasonable inquiry into whether he should bring the class claims in the face of the potential conflict of interest. The record indicates that Alioto made no reasonable inquiry into the potential conflict of interest prior to filing the complaint. The district court properly determined that Alioto thereby violated rule 11. Because Unioil management was not found liable for a rule 11 violation, we need not assess defendants' allegation that the class claims filed by Alioto were part of a ploy by Unioil management to divert shareholders from suing Unioil and its management.

The district court provided at least two additional grounds for its imposition of sanctions in its November 1984 order. Because we conclude that the primary grounds by themselves are sufficient

to sustain the sanctions imposed in the November 1984 order, we have no reason to address these additional grounds.

B.

In its January 1985 order imposing rule 11 sanctions on Alioto for filing a motion to reconsider, the district judge found that Alioto had made "a total lack of any showing that the court [had] failed to consider a material fact presented to it." She further found that Alioto had unnecessarily and unreasonably multiplied the litigation. On appeal, Alioto argues only that he had a good ground to bring the motion, since the district court in its November 1984 order had, he argues, failed to consider evidence that he had relied on Barton. The district judge, however, had not failed to consider such evidence; on the contrary, she had held that the evidence was not sufficient to show that Alioto had relied on Barton. We affirm the court's ruling that Alioto's motion to reconsider violated rule 11.

C.

Once a court finds that an attorney has violated rule 11, it *must* impose sanctions. *Zaldivar*, 780 F.2d at 831; *accord Albright v. Upjohn Co.*, 788 F.2d 1217, 1221-22 (6th Cir.1986); *Westmoreland v. CBS, Inc.*, 770 F.2d 1168, 1174-75 (D.C.Cir.1985) (*Westmoreland*). Rule 11 authorizes a court to impose "an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee." Fed.R.Civ.P. 11 "The selection of the type of sanction to be imposed lies of course within the district court's sound exercise of discretion." *Westmoreland*, 770 F.2d at 1175.

In its November 1984 and January 1985 orders, the district court ordered sanctions against Alioto in the amount of reasonable expenses, including attorneys' fees, incurred because of the papers filed in violation of rule 11. This type of sanction plainly comports with rule 11, and we find no abuse of discretion.

Alioto further challenges the amount of the rule 11 sanctions—$294,141,10, to be offset by any reimbursement received by defendants within thirty days pursuant to the rule 41(a)(2) conditional voluntary dismissal. Assisted by a magistrate, the district court determined this amount after careful proceedings in which Alioto fully participated. Alioto's arguments on appeal amount to nothing more than a blanket charge that the amount of the sanctions is patently unreasonable. We agree that the expenses and attorneys' fees determined to have been incurred by the defendants were substantial. But we cannot find them patently unreasonable in light of the massive liability that the complaint filed by Alioto threatened to impose upon multiple defendants.

AFFIRMED IN PART; DISMISSED IN PART.

Appendix B

United States District Court
Central District of California
NO. CV 84-1833-PAR(Bx)

Unioil, Inc., et al.,
Plaintiffs,

vs.

E. F. Hutton & Co., Inc., et al.,
Defendants.

Memorandum of Decision
[Filed Nov. 21, 1984]

This is a purported class action on behalf of Unioil shareholders in which the named plaintiffs are Unioil, its President Melvin Lloyd Richards, Heck Oil, Inc., Heck & Heck, Inc., and Mark Zelezny, against various broker-dealers alleging market manipulation of Unioil stock. Until recently all plaintiffs were represented by Donald Barton ("Barton") and Joseph L. Alioto of Alioto & Alioto ("Alioto"). Plaintiffs Heck Oil, Inc., Heck & Heck and Zelezny have moved for approval of their dismissing class action claims; and various defendants have moved for sanctions against all plaintiffs and their counsel (except for newly substituted counsel for Unioil and Richards). Based upon the papers, oral argument and supplemental briefing requested at the hearing on the motions, the court concludes that the motion for approval of dismissal should be granted on certain conditions and that sanctions should be awarded for counsel's violation of F.R.Civ.P. Rule 11.

FINDINGS OF FACT

1. Plaintiff Unioil, Inc. is a company engaged in oil and gas exploration and production. During 1983, its stock apparently rose in value rapidly from about $1.25 per share in the early part of the year to about $13.75 per share in mid-December. In late December, the stock price fell off somewhat to about $10 per share and held at that level until early February, 1984.

2. On February 7, 1984, The Wall Street Journal published an article about Unioil, raising some doubts about the accuracy of the company's public announcements and disclosing that one of its top executive officers, plaintiff Melvin Lloyd Richards, had previously been cited by the Securities and Exchange Commission for making false or misleading statements on two prior occasions.

3. In the days just before and after the publication of this article, Unioil's stock plummeted from around $10 per share to $2.625 per share. The stock is now trading at about $3 per share.

4. On February 16, 1984, defendant Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ") filed suit against Richards and others to collect on a promissory note Richards allegedly had given DLJ. Richards allegedly gave DLJ the note in an attempt to settle a number of trading accounts maintained by persons allegedly associated with Richards which were in default as a result of unpaid purchases of Unioil stock. DLJ later amended its complaint in that action to name as defendants Heck Oil, Inc. and Heck & Heck, Inc., two companies that had maintained the alleged delinquent accounts. Both Heck Oil and Heck & Heck are also Plaintiffs in this action.

5. On February 22, 1984, Unioil issued a press release announcing that it and a group of its shareholders had retained Joseph L. Alioto of the Alioto & Alioto law firm to institute a class action lawsuit alleging market manipulation of Unioil stock by a group of national brokerage firms and certain individuals. The press release listed Unioil and the Alioto law firm as contacts for the news story.

6. Mark Zelezny, one of the named plaintiffs herein, had not yet agreed to act as a plaintiff at the time that Unioil issued the press release. Zelezny deposition at 681, line 27 to 682, line 13. Zelezny, a stock broker and shareholder in Unioil, was first approached by Donald Barton, one of plaintiffs' counsel, about the alleged market manipulation of Unioil stock some time after January of 1984. Zelezny Declaration at ¶ 2. It was Barton, and not Zelezny, who first raised the subject of Zelezny's becoming a plaintiff in the case. Zelezny Deposition at 650, lines 7-9. Zelezny

did not actually agree to become a named plaintiff until three of four weeks after his first discussion with Barton. Id. at 642, lines 3-20; 670, lines 7-10; 681, line 27 to 682, line 13. This was some time between March 1 and one week prior to the filing of the complaint on March 21, 1984.

7. Zelezny had no role in selection of the lawyers who filed the complaint. Zelezny Deposition at 671, line 27 to 672, line 13. Instead, he was simply told that they would be his attorneys. *Id.* Neither anyone from the Alioto firm nor any other counsel took any direction from Zelezny in preparation of the lawsuit. *Id.* at 711, lines 4-11. Although Zelezny was told the contents of the complaint prior to its being filed, Zelezny Declaration at ¶ 4, he never spoke to Joseph L. Alioto, the lawyer whose signature appears on the complaint. *Id.* at 677, lines 12-26.

8. The complaint was filed March 21, 1984.

9. On March 29, 1984, Unioil mailed a letter to all Unioil shareholders informing them of plaintiffs' suit and soliciting contributions to a class action fund, to be sent to Barton.

10. After being served with the complaint, the defendants immediately filed motions to dismiss based, among other things, on plaintiffs' failure to comply with the class action pleading requirements of Local Rule 18.2; and immediately initiated the expedited discovery as to class certification issues that is required by Local Rule 18. Defendant DLJ served an extensive request for production of documents and noticed depositions of the five named plaintiffs and of the plaintiffs' counsel. The first of these depositions, the Zelezny deposition, was convened on May 3. Each of the other named defendants retained counsel and participated in these early proceedings.

11. On May 4, the scheduled second day of the Zelezny deposition, plaintiffs' counsel Donald Barton announced that Zelezny had decided to withdraw as a plaintiff and would not appear for further deposition. Zelezny Deposition at 246, line 4 to 248, line 21, and 253, lines 12-16. Defendants obtained an order from Magistrate Brown compelling Zelezny to appear and complete his deposition and awarding sanctions against plaintiffs. The deposition then continued on May 10, 11 and 12.

12. With the Zelezny deposition scheduled to resume on May 15, Barton informed defendants on May 14 that plaintiffs intended to dismiss their suit under Rule 41(a)(1) and that none of the plaintiffs or their attorneys would appear for further depositions. See Howard Declaration at ¶ 17.

13. Plaintiffs filed a notice of dismissal under Rule 41(a)(1) purporting to dismiss the entire lawsuit on May 15, 1984, and maintaining that no court approval was necessary. On the same day DLJ filed an objection on the ground that Rule 23(e) precludes dismissal of a purported class action without court approval. On May 24, plaintiffs filed a motion seeking court approval of their dismissal without prejudice pursuant to Rule 41(a)(2). Defendants filed substantial papers in opposition.

14. Thereafter, through newly retained counsel, plaintiffs Unioil, Inc. and Melvin Lloyd Richards filed a withdrawal of the motion seeking court approval of dismissal.

15. Zelezny's understanding of the facts underlying the complaint is in many critical respects contrary to the allegations of the complaint. While the complaint alleges that defendants' conduct of "short selling" Unioil stock drove the price of the stock down and caused plaintiffs to sell the stock at a loss, complaint at ¶¶ 19-26, 28 and 31, Zelezny stated that his awareness of the short selling of Unioil stock caused him to purchase the stock, rather than sell it, based on his belief that the short sellers would eventually drive the price of the stock up. Zelezny Deposition at 232, line 17 to 239, line 2; 412, line 10 to 413, line 22; 418, line 7 to 419, line 11.

16. While the complaint alleges that the plaintiffs sold Unioil stock at depressed prices between December 1, 1983 and February 29, 1984, Zelezny testified that he thought that Unioil was trading at a fair price during the period up until February 7, 1984. Zelezny Deposition at 627, line 24 to 628, line 23; and 675, line 27 to 677, line 2.

17. While the complaint alleges that plaintiffs engaged in stock transactions based on the false negative statements by defendants, Zelezny testified that he never bought or sold any

Unioil stock based on anything said by any of the defendants. Zelezny Deposition at 731, line 27 to 732, line 6.

18. Alioto is an experienced and prominent law firm known to concentrate on complex business litigation such as antitrust, securities and class actions. The firm so held itself out in connection with their representation of plaintiffs in this case; and requested and received a $100,000 retainer.

19. Defendants have incurred substantial legal expenses on account of the class action allegations and as a result of counsels' having certified that they were brought in compliance with F.R.Civ.P. Rule 11. These would not have been necessary had the class action plaintiffs been named and the complaint filed, and had class action discovery and dismissal proceedings been conducted, in conformity with the Local Rules of the Central District and as contemplated by Rule 11. Plaintiffs' counsel concedes that if plaintiffs dismiss this action, defendants will not need class action discovery. Memorandum in support of motion for order of dismissal without prejudice, page 6. Thus, except for work done on the substantive aspects of their motions to dismiss plaintiffs' complaint, the legal work engaged in by defendants has been needlessly undertaken.

20. Although Alioto argues that the class allegations pertain only to Zelezny, Heck & Heck and Heck Oil, not to Richards and Unioil, it is impossible to discern this from the pleading actually filed. *See e.g.*, complaint, ¶¶ 6, 7, 8, 9, 10.

21. Heck & Heck, and Heck Oil are major shareholders of Unioil and appear to be closely aligned with Unioil and Richards. It was at their suggestion that Richards consulted with Alioto and it was they who posted the retainer with Alioto.

22. Documents purporting to be "Declarations" submitted by Alioto in connection with these motions are neither affidavits nor under penalty of perjury. See 28 U.S.C. § 1746; F.R.Civ.P. 56(e); Local Rule 7.5.3. Having signed the papers in opposition was therefore also in violation of Rule 11.

CONCLUSIONS OF LAW

Conditions on Dismissal of Class Action.

(1) A plaintiff's voluntary dismissal may be subject to such conditions, including costs and attorneys' fees, as the court deems appropriate to protect the defendant from prejudice or inconvenience. *Davis v. McLaughlin*, 326 F.2d 881 (9th Cir.1964), *cert. denied*, 379 U.S. 833 (1964); *GAF Corp. v. Transamerica Ins. Co.*, 665 F.2d 364 (D.C. Cir. 1981). Costs and fees incurred by defendants in moving to dismiss the compliant (at least to the extent of its class action allegations), in conducting discovery directed to class certification issues, and in responding to plaintiffs' original attempt to dismiss voluntarily without court approval were incurred solely because of the class allegations and plaintiffs' failure to dismiss their representative claims once it appeared appropriate to do so. [J. M. Alioto Declaration ¶ 2 (no later than mid-April, when the *Wolfe, Wilson* and *Deutsch* suits were filed).] However, costs and fees attributable to defendants' efforts to oppose the motion for court approval should not be reimbursed as a condition to dismissal without prejudice.

(2) Although no class action has been certified, Local Rule 18.5 specifies that the requirements of F.R. Civ.P. Rule 23(e) apply to "purported class actions" as well. Even those cases relied upon by plaintiffs recognize that notice of withdrawal is appropriately given when the putative class members could have been induced to rely on the filing of the suit by the named plaintiffs. *See Pearson v. Ecological Science Corp.*, 522 F.2d 171 (5th Cir. 1975); *Robinson v. First National City Bank*, 482 F.Supp. 92 (S.D.N.Y. 1979).

Here class members received an announcement of the suit, informing them that defendants were pursuing an action in their behalf and soliciting their contributions; and a press release was issued about the impending class acton. Absent class members may therefore not be acting on their claims in reliance upon this lawsuit. As there is also an indicaton that the class action allegations were made by the named plaintiffs without a substantial foundation in fact, it would not be unfair to impose the economic burden of re-noticing the class. At the same time, there

are now pending three shareholder class action suits which may mean (a) that class members' claims against the broker defendants, if any, are tolled as well so that there is no statute of limitations problem and (2) that the most efficient and least confusing vehicle for notifying the class of the voluntary dismissal of the class action against the broker defendants is when the class determination is made in *Wolfe, Wilson* and *Deutsch*.

Sanctions.

Plaintiffs' arguments as to why sanctions for violations of Rule 11 should not be awarded are not persuasive. *First*, there is nothing in Rule 11 which precludes imposition of sanctions prior to conclusion of the litigation. While I recognize that to make the findings required for a Rule 11 violation (that the motion or pleading is not well-grounded in fact and warranted by existing law, for an improper purpose) may in some instances have overtones of a premature determination of malicious prosecution, nevertheless the Rule expressly contemplates an award of sanctions in connection with a "motion or other paper" in violation of Rule 11, as well as a pleading, and provides for a determination of sanctions upon motion by a party or the court on its own initiative, at a time within the judge's discretion. Advisory Committee Note, 97 F.R.D. 200-01. Moreover, in this case even that possibility is obviated because the conduct violative of Rule 11 does not go to the merits. The only conduct found contrary to Rule 11 and subject to sanctions is the failure by counsel who signed the pleadings so much as to consult with one of his clients before bringing a class action in part in his name, when that consultation would or should have readily disclosed that that person's experience was contrary to that about which the class was to complain and that a potential conflict of interest was inherent in undertaking representation of a class action in which one of the named plaintiffs was Unioil; thereafter to try to disengage both from class discovery without cause and from the class action suit without seeking court approval; and to oppose defendants' motions based on declarations which plainly do not comport with the requirements for statements under oath in federal court.

Second, no showing of bad faith is required. As put by the Advisory Committee notes: "The new language stresses the need for some prefiling inquiry into both the facts and the law to satisfy the affirmative duty imposed by the rule. The standard is one of reasonableness under the circumstances.... This standard is more stringent that the original good-faith formula and thus it is expected that a greater range of circumstances will trigger its violation." *Id.* at 198-99.

Third, there is no substantial evidence to show that plaintiffs' counsel made any reasonable inquiry to determine whether the shareholder class action claims were well-grounded in fact, warranted under existing law, and not interposed for an improper purpose. There was ample time for investigation, but Alioto never discussed the claim he asserted for Zelezny in behalf of the class with him. The importance of doing so is manifest because he was the only named shareholder with the appearance of independence from Unioil. There is no showing that Alioto relied on Barton's having done so, or that Barton did anything more than simply solicit Zelezny as a plaintiff and determine in a cursory way that he had made transactions in Unioil stock. It is implausible that counsel as experienced as Alioto would not have perceived the conflict of interest inherent in representing Unioil and Richards and their purporting to represent Unioil shareholders; or the inappropriateness of Zelezny's serving as a representative plaintiff when his view of the facts *contradicted* those upon which the complaint proceeds. *Cf. Surowitz v. Hilton Hotels*, 383 U.S. 363 (plaintiff didn't *understand* complaint).

Nor, apart from Zelezny's testimony, is there any substantial evidence that plaintiffs' counsel reasonably investigated the facts upon which the class action allegations were made. The declarations of Richards, Joseph L. Alioto, Joseph M. Alioto and Heckenkamp do not comply with *any* of the applicable rules for presentation of admissible evidence. C.C.P. § 2015.5; Local Rule 7.5.3; F.R.Civ.P. Rule 56(e). Even were they fully credited, nothing in these statements supports a finding that a reasonable investigation was made with respect to the class action aspects of the complaint.

Moreover, it appears that Alioto's causing the class action complaint as to plaintiffs Richards and Unioil to be filed, followed by requesting dismissal was also in violation of Rule 11. Although §§ 9 and 10 of the complaint tend to suggest that only Zelezny and the Heck plaintiffs bring the action as a class action, both the motion for dismissal without prejudice and memorandum in support speak for all plaintiffs [Memo, page 2, lines 4-8] and admit that "the plaintiffs asserted the claims in their complaint both as individual claims, and as class action claims, brought on behalf of a class consisting of Unioil shareholders." Memo, page 2, lines 15-17. Further, their motion (and proposed order) filed May 24, 1984 sought dismissal of "the action" without prejudice, motion, page 2; their reply memorandum re: requests for dismissal and sanctions filed July 31, 1984 by Alioto and Barton indicates that plaintiffs have requested leave "to dismiss class action allegations" and "in the alternative . . . that the complaint be dismissed as the procedural predicate to asserting counterclaims or third party claims against the broker-defendants;" they then withdrew their motion August 7, 1984; and the joint memorandum of plaintiffs Unioil and Richards in opposition to defendants' request for awards of costs, attorneys' fees and sanctions indicates that they intend to file separate amended complaints articulating these plaintiffs' claims less ambiguously and without conflict. Memo, page 3, line 15. Under these circumstances, defendants' request for sanctions is not mooted, as counsel contends, but is substantiated.

Although counsel argues that they sought to dismiss the class allegation because of a conflict of interest which arose when the *Wilson, Wolfe* and *Deutsch* class action against Unioil and Richards were filed, this does not excuse (a) their not having anticipated a conflict at the time of bringing and signing the complaint, or (b) their not simply withdrawing claims, if they legitimately believed the class aspects of the complaint were well-grounded in fact and were not interposed for an improper purpose. Given the Alioto firm's holding itself out as experienced and specialized in complex business litigation, they clearly should have known of the potential for conflict inherent in their pursuing a class action in the name of the company on behalf of the shareholders, had their been any meaningful investigation of independent shareholder

claims prior to proceeding. Moreover, the fact that the *potential* for conflict no longer exists by virtue of plaintiffs having retained separate counsel is immaterial on the issue of whether it did when the pleadings were filed and while the matter was initially prosecuted.

At the hearing on defendants' motion Alioto argued (a) that in an antitrust case it would be impossible for plaintiff's counsel to consult with the co-conspirators before bringing suit; (b) that the charges made have merit; and (c) that defendants have not been predjudiced because the claim will be pursued against the broker defendants. As to the first, suffice it to say that this is not primarily an antitrust action and the issue is not about contacting conspirators, but consulting with one's own client. So far as the second point is concerned, the individual claims may indeed have merit but counsel did not even argue that the *class action* claims do. It is as to them that the violations of Rule 11 pertain. Finally, defendants have been prejudiced because they were compelled to respond to class pleadings, to initiate class discovery and to oppose counsel's attempt to dismiss the class allegations, all of which would have been obviated had the Rule 11 certification been taken seriously.

Fourth, plaintiffs filed their notice of dismissal without apparently having considered or researched the impact of F.R.Civ.P. Rule 23(e). [See Memo in Support, page 8, lines 104.]

Finally, there is no substantial evidence that Alioto so acted at the direction of Unioil, Richards or the Heck interests. Their declarations indicate that they relied upon Alioto for expertise in how to proceed in matters of this sort.

Accordingly it is ordered as follows:

1. Plaintiffs Heck & Heck, Heck Oil Co. and Zelezny's motion for approval of dismissal under Rules 23(e) and 41(a)(2) shall be granted without prejudice as to their individual claims, and without prejudice as to their representative claims only on condition that notice be given in a form approved by counsel for plaintiffs and defendants in the *Wilson, Wolfe* and *Deutsch* class action and at the time of notice, if any, required to be given in these actions to all

Unioil shareholders to whom the March 29, 1984 notice to shareholders was sent, and on the further condition that plaintiffs and/or Alioto and Barton reimburse defendants for their costs and expenses, including attorneys' fees, reasonably incurred in defending against the class action claims. Costs of the notice shall be personally advanced by counsel in accordance with Local Rule 18.5.1.

2. Defendants' motion for sanctions as to Alioto, in connection with filing the class action complaint shall be granted. The sanctions shall be in the amount of the reasonable expenses incurred because of the filing of these pleadings, including reasonable attorneys' fees, as determined by the court in accordance with the criteria set forth in *Kerr v. Screen Extras Guild, Inc.*, 526 F.2d 67 (9th Cir. 1975), *cert. denied sub nom Perkins v. Screen Extras Guild, Inc.*, 425 U.S. 951 (1976), after the exercise of billing judgment by counsel for defendants to eliminate inappropriate duplication of effort, and after crediting whatever reimbursement is made in accordance with the court's order conditionally approving plaintiffs' voluntary dismissal.

3. The defendants' justification for attorneys' fees shall be referred to a Magistrate for determination in accordance with this Order.

4. The sanctions so determined shall be paid by Alioto no later than 30 days after entry of this Court's order approving the findings of the Magistrate.

DATED: November 21, 1984.

/s/ PAMELA ANN RYMER
Pamela Ann Rymer
United States District Judge

Appendix C

United States District Court
Central District of California

No. CV 84-1833-PAR(Bx)

Unioil, Inc.; Melvin Lloyd Richards, etc., et al.,
Plaintiffs,

vs.

E. F. Hutton & Co., Inc., etc., et al.,
Defendants.

ORDER

[Filed Jan. 18, 1985]

On November 21, 1984 the court issued a Memorandum of Decision (a) granting plaintiffs' motion for approval of dismissal without prejudice as to their individual claims and, and without prejudice as to their representative claims on condition that notice be given to Unioil shareholders and that plaintiffs and/or their counsel, reimburse defendants for their costs and expenses, including attorneys' fees, reasonably incurred in defending against the class action claims of the complaint; and (b) imposing sanctions on Alioto & Alioto ("Alioto") for violations of Rule 11 of the Federal Rules of Civil Procedure. Alioto has moved to reconsider on the ground that there was "a manifest showing of a failure to consider material facts presented to the Court *before* such decision," Local Rule 7.16(c) (emphasis added), and although not so stated in the Notice or supported in the Memorandum, that relief from the "final order" should be granted for some other reason justifying it, F.R.Civ.P. 60(b). Having considered the papers submitted in support of the motion to reconsider, and having issued a written tentative ruling and heard argument of Joseph L. Alioto, the court concludes that the motion to reconsider must be denied.

The moving papers nowhere indicate any fact which was brought to the court's attention *before* its decision was rendered which was not considered. The court's written tentative ruling, issued in advance of argument, was rather extensive in its listing

of the facts upon which it was inclined to award the sanctions requested; oral argument by Joseph M. Alioto was extensive, as I believe was the court's exchange of views with him; and the court's Memorandum of Decision and Order was equally extensive in reciting both the facts and law upon which it was based.

The only "facts" which are presented in connection with Alioto's motion to reconsider which were not considered before were not so considered because they were not brought to the court's attention, despite the fact that both Joseph L. Alioto and Joseph M. Alioto submitted declarations in support of their opposition to defendants' original motions. Those "facts" are (1) that Joseph L. Alioto sent a draft of the complaint to referring counsel Barton before filing it, and added Zelezny's name as a representative party plaintiff thereafter at Barton's suggestion; and (2) that Minneapolis attorney Daniel L. Shulman was asked for and gave advice to Alioto about a potential conflict of interest sometime in May, 1984. These clearly are not newly discovered; nor does there appear to the Court to be any reason why they could not, and should not, have been presented to it in connection with the opposition to defendants' requests for sanctions. That they were not leads the Court to question both credibility, and counsel's good faith in opposing the motions orginally and in moving on this basis to have the Court's ruling reconsidered.

Even had these "facts" been timely presented, and even were the Court to consider them now, nothing about them suggests that the ruling was unwarranted. To the contrary, the rationale upon which the Court predicated its earlier finding of violation of Rule 11 is substantiated.

Reliance on forwarding counsel. Although reliance on forwarding counsel is certainly *one* of the factors which may be taken into account, *see e.g.*, Advisory Committee's Note; *Huettig & Schromm v. Landscape Contractors Council*, 582 F.Supp. 1519 (N.D. Cal. 1984), it is not the *only* factor. Moreover there is nothing in this record to indicate that Alioto's reliance on the referring counsel in this case was justified. It is uncontroverted that the referring counsel himself took no directions from Zelezny; Alioto had never previously worked with that counsel

(or with the clients); and there is not a single ioto of evidence from which it could reasonably be inferred that the Alioto firm knew anything about Barton, his experience in matters of this sort, or *his* investigation. Mr. Alioto conceded at the hearing that he had asked Barton no questions which would have elicited such information about Zelezny as whether he was a sophisticated investor, relied upon any representations by any of the defendants, or would fairly and adequately represent the class. Thus when the Rule 11 certificate was executed there were no facts known to Alioto about Zelezny's Rule 23 qualifications; and the only fact bearing on the merits of the pleading known to the firm at the time of filing was that Zelezny had sold Unioil stock the day after the Wall Street Journal article. Finally, it is not without significance that the Heck & Heck Declaration, signed by referring counsel Barton August 10, 1984 in connection with the opposition to defendants' motions, stated that "*Mr. Alioto was to be the main counsel and would decide all important matters such as* direction, *parties* and strategy of this lawsuit, while Mr. Barton, who was already informed of the information surrounding this case, would act to help Mr. Alioto in obtaining information from shareholders, coordination and perform a modicum of other acts that were necessary." (Emphasis added.) Thus it was assumed by referring counsel that Jospeh L. Alioto would be responsible for determining important matters such as who should be, and who should not be, a party.

Consultation with attorney Shulman. Whether or not Alioto consulted with Shulman and regardless of the advice Shulman may have given, is immaterial to the only issue of significance before the court: *i.e.*, the investigation which should have been, but was not, done *before* the complaint was filed. Had Alioto made any such investigation, it would have been discovered that Zelezny was a sophisticated purchaser, never relied on any statements made by any defendant, and that his story was in many critical respects disparate from that set forth in the complaint, *see* Memorandum of Decision and order ¶¶ 15-17, thus belying Joseph L. Alioto's averment in his declaration submitted in support of this motion that the "facts" upon which the complaint was filed "applied to every shareholder." Moreover if any such investigation had been conducted, including a careful reading and follow-

up of the February 7, 1984 Wall Street Journal article which alluded both to unhappy shareholders and an unhappy SEC, no reasonable let alone experienced counsel could have concluded that no shareholder class action was possible and no conflict inherent in representing both Unioil and shareholders as class action plaintiffs—without so much as talking to, or being assured that some other counsel had talked to a shareholder who was independent of the company. Finally, although both the declarations and memorandum submitted in connection with this motion to reconsider persist in asserting that the complaint was brought in behalf of Unioil for itself and Richards for himself, *see* Joseph L. Alioto Dec'l. p. 4; Memorandum, p. 1, that plainly is not the case. *See* Complaint, ¶ 6; Memorandum in support of motion for dismissal, p. 2:4-8, 15-17 ("the plaintiffs asserted the claims in their complaint both as individual claims, and as class action claims, brought on behalf of a class consisting of Unioil shareholders.") Thus the only materiality of the Shulman Declaration is its implication that his consultation was with respect to the propriety of *Unioil's* prosecuting a class action. The Court therefore finds counsel's lack of candor a further ground upon which to invoke the sanctions of Rule 11.[1]

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[1] In this connection the Court is also constrained to note that contrary to what Alioto implies, there are several reported opinions which appear to question the conduct of the firm. *See, e.g., PFEL v. R.J. Reynolds,* 1981-2 Trade Cas. ¶ 64,412 (N.D. Cal. 1981); *Syufy Enterprises v. Columbia Pictures Industries, Inc.,* 1978-2 Trade Cas. ¶ 62,710 (D. Utah, 1978); *Davis v. Alioto,* ____ Cal.App.3d ____. Further, although Joseph L. Alioto states under oath in his Declaration in Opposition to Defendants' Response that among the material facts in the Court's opinion which are "unfounded" are "that our office 'held itself out' as an experienced 'class action' firm," Dec'l. p. 2:16-17, and that "our office has not 'held itself out' as experts in any field, let alone 'class action' experts," Id. at 4:16-17, the Memorandum in support of the motion to reconsider states as the first of the "Basic Facts" that "Joseph L. Alioto is an experienced and prominent attorney known to specialize in complex business litigation, including antitrust, securities and class action cases," Memorandum, p. 3:20-22, and the complaint alleges that plaintiffs' attorneys are "skilled and experienced in class action and civil litigation." Complaint, ¶ 6.

At argument counsel advanced three items which he suggested the court had misapprehended. First, that this is not primarily an antitrust case. Whether it is "primarily" an antitrust case is beside the point; that it is *also* a securities case, with pendent claims of fraud and misrepresentation, is the point. Each of those claims requires reliance as a necessary element of proof. Named plaintiff Zelezny in his deposition, taken but a few weeks after the complaint averring *his* reliance was filed, testified instead to his *non*-reliance. There is no explanation in the record for why this critical fact would not have been uncovered had counsel executing the Rule 11 certificate inquired of Zelezny directly, or asked referring counsel to do so. Second, that Zelenzy's deposition contradicted a fact which was alleged. Clearly it did with respect to reliance. Third, that paragraphs 9 and 10 of the complaint, which designate Zelezny and Heck as representatives of the class, should be taken at face value. To the court, and doubtless to counsel for defendants—and obviously also to consulting counsel Shulman—paragraph 6 of the complaint alleges that all plaintiffs, including Unioil and Richards, are class representatives. In any event these matters were considered by the court before its prior ruling and none was misapprehended so as to warrant a reconsideration.

Not only is there a total lack of any showing that the court failed to consider a material fact presented to it, but there also is no new law relied upon by Alioto which was not considered by the court. Instead Alioto reasserts and reargues *Nemeroff v. Abelson,* 620 F.2d 339 (2d Cir. 1980), which was asserted and argued before and which the court has already considered and rejected as the applicable authority, its having been decided before the amendment to Rule 11. In so doing Alioto does not cite to *any* post-Rule 11 authority, *e.g., Huettig & Schromm; Heimbaugh v. City & County of San Francisco,* 591 F.Supp. 1573 (N.D. Cal. 1984); *Larkin v. Heckler,* 584 F.Supp. 512 (N.D. Cal. 1984); *Golden Eagle v. Burroughs Corp.,* 103 F.R.D. 124 (N.D. Cal. 1984) to cite only those by courts in this circuit. These, together with the Rule itself and the Advisory Committee's Notes, make it clear that the bad faith standard of *Nemeroff* is no longer a criteria. To reargue *Nemeroff* under these circumstances (with no intervening authority which favors Alioto's position and in the

face of authority which controverts it) is tantamount to bad faith, *Roadway Express, Inc. v. Piper,* 447 U.S. 752 (1980); *United States v. Blodgett,* 709 F.2d 608 (9th Cir. 1983), and is at least a reckless disregard for the judicial process within the meaning of 28 U.S.C. § 1927.

Because the motion to reconsider does not meet the requirements of Local Rule 7.16 the Court shall not reconsider its prior ruling. For that reason also, Local Rule 7.19 and 27.1 are implicated. In addition, since the motion to reconsider in substantial part replicates arguments advanced in the original opposition, and to the extent that it does not relies on "facts" known to the proponents prior to consideration of the motion but brought forward as a second shot, this litigation has been unnecessarily and unreasonably multplied. Thus § 1927 is implicated. Accordingly it is ordered that sanctions in the amount of attorneys' fees, costs and expenses reasonably attributable to opposing the motion to reconsider shall be awarded. Counsel for the opposing parties are to submit substantiation to the Magistrate in accordance with a schedule to be arranged with his clerk. Once the Magistrate's recommendation is received for approval and action has been taken on it by this Court, a final Order reflecting this decision, together with the prior decision, shall be entered.

IT IS SO ORDERED.

DATED: January 14, 1985.

/s/ PAMELA ANN RYMER
Pamela Ann Rymer
United States District Judge

Appendix D

United States Court of Appeals
For the Ninth Circuit

No. 85-6024
D.C. No. CV 84-1833-PAR

Unioil Inc., et al.,
Plaintiffs,

and

Heck Oil, Inc.; Heck & Heck, Inc.; and Mark Zelezny,
Plaintiffs-Appellants,

vs.

E.F. Hutton & Co., Inc.; Kurt Feshback; Stockbridge Partners, Inc.; Richard Jacoby; Haim Pekelis; Shearson-American Express, Inc.; and Goldman Sachs & Co.; and Donaldson, Lufkin & Jenrette Securities Corp.,
Defendants-Appellees.

Appeal from the United States District Court
for the Central District of California

ORDER AMENDING OPINION
AND DENYING REHEARING

[Filed Feb. 26, 1987]

Before: WALLACE, FARRIS, and CANBY, Circuit Judges.

The opinion in the above case filed on October 15, 1986, is hereby amended as follows:

On page 21 of the slip opinion, first full paragraph, delete " 's arguments violated his duty of candor, were 'tantamount to bad faith,' and" on lines 5 and 6. In the same paragraph, delete "Considering also the district court's findings of lack of candor and bad faith," on lines 14 and 15, and then capitalize the "w" in the word "we" on line 15.

The panel as constituted above has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for rehearing en banc is rejected.

Appendix E

Central District of California

Honorable Pamela Ann Rymer, Judge Presiding

Master File
No. CV 84-2359-PAR

In re Unioil Securities Litigation

Reporter's Transcript of Proceeding, Pages 48-49

Los Angeles, California

Monday, August 20, 1984

Elaine J. Cohen, CSR 2706
Official Reporter
442-A U.S. Courthouse
312 North Spring Street
Los Angeles, California 90012
(213) 680-1639

* * *

THE COURT: Well, having listened as carefully as possible to Mr. Alioto's verbal explanation this morning, I must say that I am not persuaded that my tentative disposition was incorrect. It seems to me that the minimum that the new amendment to Rule 11 requires is some prefiling inquiry into both the facts and the law and that this is an affirmative duty which is imposed upon counsel. I believe that the standard is not whether it is either willful or in bad faith or in good faith but, rather, whether the prefiling inquiry which was conducted was reasonable under the circumstances as they existed at the time the complaint was filed.

I want to reiterate, lest there be any mistake about it at all, that at this point I am making no statement whatsoever with respect to

the merits of the substantive allegations which were made nor, indeed, am I making any statement with respect to whether there may have been lurking a class action. What I am, however, stating and stating in absolutely unequivocal terms is that I think it is incumbent upon a lawyer practicing in federal court at a minimum to consult with the named plaintiffs in a class action lawsuit and to satisfy himself that that plaintiff is a representative plaintiff and has a viable cause of action. I believe it is incumbent upon counsel before signing and filing a complaint to be satisfied that there is a foundation in fact for the case to be brought in behalf of each of the named plaintiffs. [Emphasis added]

Appendix F

United States District Court

Central District of California

Honorable Pamela Ann Rymer, Judge Presiding

Master File
CV 84-2359-PAR
CA 85-6024

In re Unioil Securities Litigation

Reporter's Transcript of Proceeding, Page 27

Los Angeles, California

January 14, 1985

Elaine J. Cohen, CSR 2706
442-A U.S. Court House
312 North Spring Street
Los Angeles, California 90012
(213) 680-1639

[The Court]

I think it also should bear repeating or emphasizing that I expressly indicated, both from the Bench and in the written Order, that my decision was not intended to and should be taken as having no effect whatsoever on the substantive allegations of the complaint; therefore, all that you have suggested today with respect to the law of conspiracy and with respect to advances in the law of antitrust simply is not germane to what concerns prompted my prior decision. Those concerns were solely directed to the class action aspects of the complaint. [Emphasis added.]

Further, to the extent that there is any misapprehension on your part or on anybody else's part that my ruling was in any way intended to speak to the propriety of an attorney's taking on a doctrine which the attorney thinks is wrong, that is an incorrect apprehension. I certainly recognize both the propriety and indeed the obligation of an attorney who believes a doctrine to be wrong to take it on so long as he does so frontally and in compliance with the obligations of Rule 11. I'm not at all saying that that's the case here and my ruling does not at all speak to the merits of the substantive allegations which were made.

* * *

(2) (2)

Supreme Court, U.S.
FILED
JUL 24 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1918 and No. 86-1894

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1987

ALIOTO & ALIOTO, et al.,
Petitioners,

DONALD A. BARTON,
Petitioner,

VS.

E. F. HUTTON & CO., INC., et al.,
Respondents.

JOINT AND CONSOLIDATED BRIEF OF RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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QUESTIONS PRESENTED

The petitions for certiorari in this case raise two separate and distinct issues.

1. *In No. 86-1918:* Whether the Ninth Circuit's unanimous decision affirming the district court's award of sanctions under Fed. R. Civ. P. 11 against an attorney for failing to make a "reasonable inquiry" into whether a class action complaint under the federal securities laws was "well grounded in fact" is appropriate for review by this Court, when it: (a) rests on findings of fact by the district court, unanimously affirmed by the Court of Appeal, that are not subject to review by this Court; (b) involves no important questions of federal law; and (c) involves application of well-settled law under Rule 11 as to which there is no conflict among the circuits.

2. *In No. 86-1918 and No. 86-1894:* Whether the Ninth Circuit's unanimous ruling that the district court's imposition of conditions on the granting of plaintiffs' motion for dismissal without prejudice pursuant to Fed. R. Civ. P. 41(a)(2) is not appealable is appropriate for review by this Court when: (a) as the Ninth Circuit found, petitioners elected below to acquiesce in the conditions; (b) as the Ninth Circuit ruled, petitioners may seek review by way of petition for writ of mandamus; (c) the Ninth Circuit's ruling raises no important questions of federal law; and (d) the Ninth Circuit's ruling involves no conflict among the circuits.

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No. 86-1918 and No. 86-1894

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1987

ALIOTO & ALIOTO, et al.,
Petitioners,
DONALD A. BARTON,
Petitioner,
vs.
E. F. HUTTON & CO., INC., et al.,
Respondents.

JOINT AND CONSOLIDATED BRIEF OF RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

Respondents respectfully request this Court to deny the petitions, in No. 86-1918 and No. 86-1894, for writs of certiorari to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit.

STATEMENT OF THE CASE

In this action, District Judge Pamela A. Rymer, unanimously affirmed by the Ninth Circuit in an opinion by Circuit Judge Clifford A. Wallace (joined by Circuit Judges Jerome Farris and William C. Canby), imposed sanctions against petitioner Alioto & Alioto ("Alioto") under Fed. R. Civ. P. 11 ("Rule 11") based on Alioto's filing, without the requisite "reasonable inquiry," of class action claims not "well grounded in fact." In *No. 86-1918*, Alioto seeks review of the Rule 11 sanctions.

Separately and independently, as a condition to plaintiffs' belated effort voluntarily to dismiss those class action claims and certain individual claims without prejudice — thereby depriving respondents of a favorable adjudication on the merits and preserving plaintiffs' option to sue again — Judge Rymer required pursuant to Fed. R. Civ. P. 41(a)(2) ("Rule 41(a)(2)") that plaintiffs pay respondents their reasonable attorneys' fees and costs incurred in defending against the class action claims. The Ninth Circuit found that plaintiffs had acquiesced in the conditions by failing to withdraw their motion for dismissal without prejudice, and ruled the conditions non-appealable. In *No. 86-1894,* petitioner Donald A. Barton ("Barton") seeks review of this holding, as do petitioners in *No. 86-1918.*

Contrary to petitioners' arguments, which rely on wholesale mischaracterizations of the record, the Rule 11 sanctions rest squarely on the district court's extensive factual findings, unanimously affirmed by the Ninth Circuit, regarding Alioto's unquestioned misconduct and on application of well-settled principles of law under Rule 11. And the Rule 41(a)(2) conditions imposed on plaintiffs' dismissal without prejudice of their class action claims follow settled precedent recognizing that such conditions are appropriate to compensate defendants for the fact that they are foreclosed from obtaining a favorable adjudication on the merits, and for work done in defense of the plaintiff's claims which will not prove useful if and when those claims are reasserted in another action. As the Ninth Circuit ruled, particularly where, as here, a plaintiff acquiesces in such conditions, the imposition of conditions is not appealable, but review may be sought by petition for writ of mandamus.

To correct petitioners' misstatements, respondents summarize below the facts as found by the district court

and affirmed by the Ninth Circuit, and the grounds for the decisions below.

A. Events Prior To The Filing Of The Complaint.

During 1983, fueled by a series of optimistic public announcements by the company, the publicly traded stock of petitioner Unioil, Inc. ("Unioil") rose from $1.25 per share in the early part of the year to a high of $13.75 per share in mid-December 1983. In February 1984, Unioil's stock was trading at $10.00 per share. App. A2, B1.* On February 7, 1984, the Wall Street Journal published an article raising serious doubts about the accuracy of the company's public announcements, suggesting that Unioil was being investigated by the Securities and Exchange Commission ("the SEC"), and disclosing that Unioil's principal executive, plaintiff Melvin Lloyd Richards ("Richards"), had twice previously been cited by the SEC for making false and misleading statements.[1] Commencing shortly before publication of the article, Unioil's stock ultimately tumbled from $10.00 per share to $2.625 per share. App. A2, B2.

The disclosures in the Wall Street Journal article made highly likely — as subsequently occurred — the filing of

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*The Petition in No. 86-1918 is cited as "Alioto Pet.," and the Petition in No. 86-1894 as "Barton Pet." The Appendices to the Alioto Petition are cited as "App. ____," and the Appendices to the Barton Petition as "Barton App. ____."

[1]Alioto falsely states that the author of the Wall Street Journal article, R. Foster Winans, was later convicted of securities fraud for disseminating false information in his articles. Winans was in fact convicted for disclosing *true* information to traders just prior to the publication of that information. *United States v. Winans*, 612 F. Supp. 827, 838 (S.D.N.Y. 1985), *aff'd in part and rev'd in part sub nom. United States v. Carpenter*, 791 F.2d 1024 (2d Cir.), *cert. granted*, 107 S.Ct. 666 (1986). Winans has never been accused of any wrongdoing in connection with the Unioil article.

shareholder class action lawsuits against Unioil and its management. *See* App. A4, A14, B7-B8, B9-B10. In what now appears to have been an effort to forestall such lawsuits, on February 22, 1984, Unioil issued a press release announcing that it and a group of its shareholders had retained Alioto to institute a class action lawsuit alleging that the decline in Unioil's stock was due to market manipulation by a group of national brokerage firms and individuals associated therewith (respondents herein). App. A3, B2. Alioto is, and represented itself in this action as, experienced and specialized in complex business litigation. App. A12, B5, B9.

B. The Complaint.

The class action complaint was filed one month subsequent to the press release, on March 21, 1984. App. A2, B3. Named as plaintiffs were Unioil, Richards, petitioners Heck Oil Co. ("Heck Oil") and Heck & Heck, Inc. ("Heck & Heck"), along with petitioner Mark Zelezny ("Zelezny"). App. A2. Heck Oil and Heck & Heck were major shareholders of Unioil, and, as Alioto had reason to know, closely aligned with Unioil management. App. A2, A14, B5.[2] Zelezny was a stockbroker and shareholder of Unioil. App. A2, B2. Attorneys of record were Alioto and Barton. Alioto signed the complaint. App. A2, B3.

The complaint pled all of its substantive legal claims (except for a defamation claim brought individually by Unioil and Richards) as claims on behalf of a class of Unioil shareholders, and all plaintiffs — Unioil, Richards, Heck Oil and Heck & Heck, as well as Zelezny — were alleged to be representatives of the putative class. App.

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[2]As Judge Rymer found, it was at Heck Oil's and Heck & Heck's suggestion that Unioil and Richards contacted Alioto, and it was Heck Oil and Heck & Heck who posted the $100,000.00 retainer required by Alioto. App. B5.

A2, B5, B9. The complaint alleged that, in violation of federal securities laws: (a) respondents had illegally depressed the price of Unioil stock between December 1, 1983 and February 25, 1984 by selling the stock short and by spreading false negative rumors about Unioil; (b) plaintiffs had been induced by respondents' alleged false statements to sell their Unioil stock and did so at depressed prices; and (c) plaintiffs had sold their Unioil stock in reliance on respondents' alleged statements. App. A2, A3, B4-B5. The complaint also alleged federal antitrust and RICO claims, and claims for fraud and deceit under California law (which again specifically pled plaintiffs' reliance on respondents' alleged statements). Damages in excess of $50,000,000.00 were sought. App. A2, A3, A12, A16, B4-B5.

C. Alioto's Failure To Investigate Prior To Filing The Complaint.

Because Zelezny was the only named plaintiff with the appearance of independence from Unioil and its management, Zelezny's role in this class action litigation was critical. App. A2. As both Judge Rymer and the Ninth Circuit found, any reasonably competent business attorney would have realized, upon reading the Wall Street Journal article, the strong possibility that Unioil shareholders would sue Unioil and its management, and thus at a minimum have taken steps to investigate and insure that any class claims were represented by a plaintiff independent of Unioil and otherwise qualified under Fed. R. Civ. P. 23(a). App. A14, B9-B10. Indeed, within three weeks of the filing of this action, three separate class action lawsuits were filed by Unioil shareholders against Unioil and its management (including Richards). Each action accused Unioil's management of inflating the price of Unioil stock by making false optimistic announcements about the company. App. A4, B6, B9.

But as Judge Rymer and the Ninth Circuit found, Alioto did not so investigate. Alioto's description of the purported nature and extent of its pre-filing investigation, Alioto Pet. at 6-8, has no support in the record, and is belied by Judge Rymer's factual findings, affirmed by the Ninth Circuit.[3]

Despite a substantial retainer, ample time for investigation, and the fact that it was experienced and specialized in complex business litigation, App. A12, B5, B8, prior to filing the complaint, Alioto did *not* consider the obvious conflict inherent in simultaneously representing both Unioil and its management and a putative class of Unioil shareholders — much less the impropriety of asserting class claims with Unioil, its management and closely related entities Heck Oil and Heck & Heck as class representatives. App. A14, B8. Moreover, before filing the complaint, Alioto *never* spoke to Zelezny, the only named plaintiff even arguably independent from Unioil and its management; nor did it inquire whether Barton had investigated Zelezny's suitability as a class

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[3]Thus, there is no basis in the record for Alioto's putative factual assertions that prior to filing the complaint, Alioto held meetings with certain of the plaintiffs (not including Zelezny), reviewed "voluminous documents," explored the possibility that corporate mismanagement might have explained the drop in Unioil's stock, or "received a large favorable response from shareholders wishing to join the action against the brokers." Alioto Pet. at 7-8. Similarly, there is no record support for Alioto's putative factual assertions regarding: (1) Richards' knowledge and Heck Oil's and Heck & Heck's principal Mr. Thomas Heckenkamp's knowledge of alleged concerted short-selling of Unioil stock; (2) the trading volumes of Unioil stock during the relevant time period; or (3) respondent Feshbach's alleged letters regarding trading in Unioil stock. *Compare* Alioto Pet. at 6-8 (putative factual assertions) *with* App. B8, A1-A5 (district court ruled any such "evidence" inadmissible, and district court's findings of fact affirmed and recited by the Ninth Circuit did not include these putative "facts").

representative. App. A3, A12-A13, B2-B3, B7, B8. All Alioto knew about Zelezny at the time it filed the complaint was that, as Alioto learned from Barton, Zelezny had sold Unioil stock the day after the Wall Street Journal article appeared. App. A3, A12-A13, C3.

D. Events Subsequent To The Filing Of The Complaint.

As required by Central District Local Rule 18.4 (requiring completion of class action discovery within sixty days of the filing of a complaint), respondents immediately initiated an expedited program of discovery on class certification issues. App. B3. On the second day of Zelezny's deposition, Zelezny failed to appear.[4] Instead, Barton announced that Zelezny was withdrawing as a plaintiff. The magistrate ordered Zelezny to complete his deposition, and imposed sanctions. App. A3, B3.

At his resumed deposition, Zelezny flatly contradicted the essential allegations of the complaint. App. A3, B4. Thus:

(1) While the complaint alleged that respondents' alleged short selling had driven down the price of Unioil stock and caused plaintiffs to sell Unioil shares at depressed prices, Zelezny, a professional stockbroker, testified that he was aware of significant short selling in Unioil stock and, following a contrary strategy, *bought not sold*

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[4]Alioto obscures the circumstances surrounding the Zelezny deposition. Alioto fails to mention that: (1) Alioto never questioned Zelezny or Barton to determine whether or not Zelezny was an appropriate plaintiff or class representative; (2) Zelezny's deposition testimony directly contradicted the allegations of the complaint; (3) the Zelezny deposition took place before any effort by plaintiffs to dismiss their claims without prejudice; and (4) Zelezny sought to escape questioning by refusing to appear for the second day of his deposition. *Compare* Alioto Pet. at 9-10 (purported facts) *with* App. B3-B4 (facts as found by district court) *and id.* A3-A4 (facts affirmed by Ninth Circuit).

Unioil shares, based on his belief that the short sellers would have to buy and eventually drive up the stock price. App. A3, B4.

(2) While the complaint alleged that sales of Unioil stock made by plaintiffs between December 1, 1983 and February 29, 1984 had been at *depressed* prices, Zelezny testified that the price that prevailed during this period, until the February 7, 1984 Wall Street Journal article, was in his view the *fair market price* of the stock. App. A3, B4.

(3) While the complaint alleged that plaintiffs had engaged in Unioil stock transactions in *reliance* on false, negative statements by respondents, Zelezny testified that he had heard no negative statements or rumors about Unioil, false or otherwise, from respondents or anyone else, prior to the Wall Street Journal article, and that he had *never bought or sold Unioil stock in reliance on anything said by any respondent.* App. at A3, B4-B5.

Zelezny's deposition was scheduled for another session on May 15, 1984. On May 14, 1984, Barton announced that Zelezny would once again not appear for his deposition, that neither plaintiffs nor their attorneys would appear for any further depositions, and that plaintiffs would voluntarily dismiss the complaint. App. A3-A4, B4. On May 15, 1984, plaintiffs filed a notice purporting to dismiss their action without prejudice pursuant to Fed. R. Civ. P. 41(a)(1), maintaining that no court approval was necessary. App. A4, B4. One respondent objected on the ground that Rule 41(a)(2), Fed. R. Civ. P. 23(e) and Central District Local Rule 18.5 required court approval before a putative class action could be dismissed. App. A4, B4.

On May 24, 1984, plaintiffs filed a motion pursuant to Rule 41(a)(2) seeking court approval of dismissal of the

entire action, both class claims and individual claims, *without prejudice* — i.e., preserving their right to sue respondents again if they chose to do so.[5] App. A4, B4. In response, respondents moved for imposition of conditions on any such dismissal: attorneys' fees and costs for their defense to the extent those fees were for work which would not be useful if plaintiffs refiled any claims. Respondents also sought sanctions under Rule 11 based on Alioto having filed the class action complaint without the required reasonable inquiry into the facts. App. at A4, B4.

Unioil and Richards (through newly retained counsel) thereupon withdrew their motion seeking court approval of dismissal of their individual claims. App. A4, B4. Directly contrary to Alioto's assertion, Alioto Pet. at 27, Unioil and Richards took no further action in the case following the district court's Rule 41(a)(2) and Rule 11 rulings. Their individual claims were subsequently dismissed with prejudice for failure to prosecute. App. A5.

E. The Decisions Below.

Judge Rymer — unanimously affirmed by the Ninth Circuit — ruled that Alioto had violated Rule 11 by, among other actions, failing to conduct the required "reasonable inquiry" into the facts and, as a result, filing a complaint which, as to the critical class action allegations, was not "well grounded in fact." App. at A4-A5, A12-A14, B7-B10, C1-C5. As Judge Rymer concluded:

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[5]Alioto fails to mention that plaintiffs attempted to dismiss their claims without prejudice and without court approval before filing their Rule 41(a)(2) motion. Alioto likewise fails to specify that the only dismissal ever sought below was a dismissal *without* prejudice. *See, e.g.,* Alioto Pet. at 9.

(1) Alioto had failed "so much as to consult with one of his clients [Zelezny] before bringing a class action in part in his name." App. B7; *see* App. A3, A12.

(2) Had Alioto consulted with Zelezny, "that consultation would or should have readily disclosed that . . . [Zelezny's] experience was contrary to that about which the class was to complain." App. B7; *see* App. A13. Alioto's failure to consult with Zelezny was critical not only because it led Alioto to file a complaint which made factual allegations unsupported in fact, but also because Zelezny was the *only* putative class representative arguably independent from Unioil's management. App. B8; *see* App. A2-A3, A12.

(3) Had Alioto reasonably inquired into the facts — by, for example, conducting any follow-up inquiry regarding the Wall Street Journal article during the one month period between announcing the lawsuit and filing the complaint — it would have realized, as would any reasonably competent business attorney, the conflict inherent in undertaking simultaneous representation of Unioil and its management on the one hand, and a putative class of Unioil shareholders with possible claims against Unioil and its management on the other hand. App. B8, C3-C4, A12, A14.

As Judge Rymer explained:

> [T]here is no substantial evidence to show that plaintiffs' counsel made any reasonable inquiry to determine whether the shareholder class action claims were well-grounded in fact . . . . There was ample time for investigation, but Alioto never discussed the claim he asserted for Zelezny in behalf of the class with him. The importance of doing so is manifest because he [Zelezny] was the only named shareholder with the appearance of independence

> from Unioil. There is no showing that Alioto relied on Barton's having done so, or that Barton did anything more than simply solicit Zelezny as a plaintiff and determine in a cursory way that he had made transactions in Unioil stock. It is implausible that counsel as experienced as Alioto would not have perceived the conflict of interest inherent in representing Unioil and Richards and their purporting to represent Unioil shareholders; or the inappropriateness of Zelezny's serving as a representative plaintiff when his view of the facts *contradicted* those upon which the complaint proceeds.

App. B8 (emphasis in original). *See* App. A2-A3, A12-A14.

As Rule 11 sanctions, Judge Rymer awarded respondents their reasonable attorneys' fees and costs in defending against plaintiffs' claims, and in seeking sanctions (but not for establishing the amount of the sanctions). App. A5, B11, C6. After the filing of detailed documentation and after lengthy proceedings before the magistrate, the district court, adopting the magistrate's findings, set the amount of sanctions awarded against Alioto at $294,141.10. App. A5; Barton App. D3.

Separately and independently, Judge Rymer also granted plaintiffs' motion to dismiss their class action and certain individual claims without prejudice. Under Rule 41(a)(2), the district court imposed as a condition to dismissal without prejudice of the class action claims that plaintiffs and their counsel pay respondents their reasonable costs and expenses (including attorneys' fees) relating to defending the class action allegations — fees for work which would not be useful if and when plaintiffs refiled their claims. App. B11. Again adopting the magistrate's findings, the district court fixed the amount of conditions at $165,774.84. App. A5; Barton App. D3. To

avoid double recovery by respondents under Rules 11 and 41(a)(2), the district court provided that any amounts actually paid to respondents in conditions would reduce the amount Alioto was required to pay in Rule 11 sanctions. App. A5, B11; Barton App. D3-D4.

As the Ninth Circuit found, plaintiffs did not, in response to the Rule 41(a)(2) conditions, elect to forego the conditions by withdrawing their motion for dismissal and pursuing their claims, or by instead taking a dismissal with prejudice. Rather, with full knowledge of their option to withdraw their motion and avoid the conditions, plaintiffs accepted the conditions. App. A6-A7.

On appeal, the Ninth Circuit unanimously affirmed the award of Rule 11 sanctions. App. A10-A16. The Ninth Circuit dismissed the appeal from the Rule 41(a)(2) conditions, unanimously ruling the matter not appealable. App. A5-A10. A petition for rehearing and/or rehearing *en banc* was subsequently denied. App. D1-D2.

SUMMARY OF REASONS FOR DENYING THE WRITS

Under the standards set forth in this Court's Rule 17, neither the imposition of Rule 11 sanctions, for which review is sought in No. 86-1918, nor the Ninth Circuit's ruling that the Rule 41(a)(2) conditions are not appealable, for which review is sought in No. 86-1894 and No. 86-1918, merits review by certiorari.

A. Certiorari Should Be Denied In No. 86-1918 As To The Rule 11 Sanctions.

The award of Rule 11 sanctions does not merit review because it raises no important questions of federal law. To the contrary, the award rests on a well-established and wholly non-controversial component of Rule 11: an attorney's obligation, before signing a pleading, to conduct a

reasonable inquiry to determine that the pleading is well-grounded in fact. As this case demonstrates, application of this prong of Rule 11 is almost wholly fact-based, and there is no warrant for this Court to review the district court's factual findings, unanimously affirmed by the Ninth Circuit, which justified sanctions here. *See* Section A.1 below.

To justify review, petitioners attempt to construct conflicts among the circuits on various issues regarding application of Rule 11. But there is no conflict on the law applicable to the "well grounded in fact" prong of Rule 11. The putative conflicts both do not exist and, even if they did, are wholly irrelevant to this case. *See* Section A.2 below.

B. Certiorari Should Be Denied In No. 86-1894 And No. 86-1918 As To The Rule 41(a)(2) Conditions.

The Ninth Circuit's ruling that the imposition of Rule 41(a)(2) conditions on plaintiffs' dismissal of their claims without prejudice is not appealable does not warrant review by this Court.

No important question of federal law is raised by the non-appealability ruling. Petitioners have not been deprived of any right of review, because: (1) as the Ninth Circuit found, petitioners below acquiesced in the Rule 41(a)(2) conditions when, with knowledge of their option to avoid the conditions by withdrawing their motion for voluntary dismissal, they elected to accept the conditions; and (2) the Ninth Circuit explicitly recognized petitioners' right to seek review by way of petition for writ of mandamus. App. A6-A7, A10. Moreover, in affirming the Rule 11 sanctions, the Ninth Circuit did not, contrary to petitioners' argument, somehow necessarily pass on the validity of the Rule 41(a)(2) conditions. Rather, the

sanctions and conditions were independent, with Alioto required to pay the full amount in Rule 11 sanctions regardless of the validity of the conditions. App. A5, B11; Barton App. D3. *See* Section B.1 below.

Nor does the non-appealability ruling create a conflict among the circuits relevant to this case. The circuits agree that imposition of attorneys' fees conditions under Rule 41(a)(2) is generally not appealable. And while the Fifth Circuit may permit an appeal if a plaintiff has not acquiesced in the conditions and the conditions are "clearly" or "patently unreasonable," the Ninth Circuit recognizes that review may be had under such circumstances by way of petition for writ of mandamus. No circuit would permit review under the circumstances of this case, where plaintiffs did acquiesce and the attorneys' fees conditions are wholly reasonable. *See* Section B.2 below.

REASONS FOR DENYING THE WRITS

A. REVIEW SHOULD BE DENIED IN NO. 86-1918 BECAUSE THE RULE 11 SANCTIONS INVOLVE FACT-BASED APPLICATION OF WELL-SETTLED LAW WHICH RAISES NO IMPORTANT QUESTIONS OF FEDERAL LAW AND AS TO WHICH THERE IS NO CONFLICT AMONG THE CIRCUITS.

1. The Rule 11 sanctions involve fact-based application of well-settled law raising no important questions of federal law.

Rule 11 unambiguously requires an attorney, before filing a pleading, to engage in a "reasonable inquiry" to insure that the pleading is "well grounded in fact." As the Rule states:

> Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record .... The signature of an attorney ... constitutes a certificate ... that the signer has read the pleading, motion, or other paper; that *to the best of the signer's knowledge, information and belief formed after reasonable inquiry it is well grounded in fact* and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

(Emphasis added.)

The circuits are in agreement both as to this requirement, and as to its independence from the additional Rule 11 obligations — *not* at issue here — to investigate whether a pleading is warranted by existing law and to refrain from interposing pleadings or other papers for improper purposes. *See, e.g., Westmoreland v. CBS, Inc.*, 770 F.2d 1168, 1175 (D.C. Cir. 1985) ("*Westmoreland*"); *Zaldivar v. City of Los Angeles*, 780 F.2d 823, 831 (9th Cir. 1986) ("*Zaldivar*"). Along with the Ninth Circuit here, other circuits recognize that Rule 11 sanctions may be awarded based entirely on the "well grounded in fact" requirement. *See Elliott v. Perez*, 751 F.2d 1472, 1480-81 (5th Cir. 1985); *Albright v. Upjohn Co.*, 788 F.2d 1217, 1221 (6th Cir. 1986) ("*Albright*"); *Frazier v. Cast*, 771 F.2d 259, 263 (7th Cir. 1985) ("*Frazier*").

Alioto nowhere demonstrates that the "well grounded in fact" clause of Rule 11 has generated any issues of law meriting this Court's attention. To the contrary, as this case demonstrates, application of this clause of Rule 11 is of necessity fact-based, and will always rest on the district court's findings of fact regarding the objective rea-

sonableness of an attorney's pre-filing inquiry, and the bona fides of the relevant pleading.

Absent egregious error, this Court will not review factual findings by a district court that have been upheld by a circuit court. *United States v. Doe*, 465 U.S. 605, 613-14 (1984); *Graver Mfg. Co. v. Linde Co.*, 336 U.S. 271, 275 (1949). Thus, there is no warrant for this Court to review Judge Rymer's findings of fact, unanimously affirmed by the Ninth Circuit, that Alioto's pre-filing inquiry was not the "reasonable inquiry" required by Rule 11. App. A2-A3, A12-A14, B3, B5, B7-B10. Nor is there any warrant to review Judge Rymer's findings of fact, unanimously affirmed by the Ninth Circuit, that Alioto's failure reasonably to inquire resulted in it filing a complaint the class action allegations of which were not "well grounded in fact." App. A3-A4, A12-A14, B4-B5, B7-B9.[6]

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[6]Alioto also argues that the amount of sanctions awarded was excessive. Alioto Pet. at 18-19. The amount of sanctions is inappropriate for review by this Court because it is entirely fact-based. "The [district] court . . . retains the necessary flexibility to deal appropriately with violations of the rule. It has discretion to tailor sanctions to the particular facts of the case, with which it should be well acquainted." Advisory Committee Notes to Rule 11. In this case, the amount of sanctions was only fixed following painstaking analysis by the district court, assisted by the magistrate. Respondents submitted declarations, accompanied by detailed time records, demonstrating that the fees sought were reasonable and non-duplicative. The magistrate held two separate hearings on the fees to be awarded, and issued formal findings on the issue which were adopted by the district court. *See* App. A16; Barton App. D1-D4. As the Ninth Circuit found, in addition to the fact that "the district court determined the amount after careful proceedings in which Alioto fully participated," App. A16, the award of fees was not excessive "in light of the massive liability that the complaint filed by Alioto threatened to impose upon multiple defendants." *Id.* There is no warrant for this Court to review the Ninth Circuit's ruling that the amount of Rule 11 sanctions imposed by the district court was not an abuse of discretion. App. A11, A16.

Alioto nonetheless attempts to manufacture an important issue of federal law by asserting that to violate Rule 11, a pleading must be found to be wholly "frivolous" or in furtherance of an improper purpose. Alioto Pet. at 12. Rule 11 says no such thing, and as the Advisory Committee Notes expressly state, amended Rule 11 "stresses the need for some prefiling inquiry into both the facts and the law to satisfy the affirmative duty imposed by the rule." Nor does the case law so construe the Rule: the term "frivolous" is used either as a shorthand term to encompass Rule 11's three separate commands — "well grounded in fact," "warranted by existing law" and not interposed for an improper purpose, *see, e.g., Zaldivar*, 780 F.2d at 831 & n.7 — or to deal with the quite separate problem, not at issue here, of when an attorney may be sanctioned under the "warranted by existing law" clause of Rule 11. Indeed, all of the cases cited by Alioto involving the so-called "frivolousness" standard, *see* Alioto Pet. at 11-12 n.1, involve the "warranted by existing law" clause of Rule 11. None denies a lawyer's independent obligation under the Rule to reasonably inquire into whether a pleading is "well grounded in fact." *See, e.g., Westmoreland*, 770 F.2d at 1174.

Alioto also asserts three general controversies about the policy implications of judicial application of Rule 11. If these controversies exist, they have no relevance here.

First, Alioto argues that Rule 11 may chill effective advocacy. Alioto Pet. at 21-23, 26. But the "well grounded in fact" clause of Rule 11 — unlike the "warranted by existing law" clause — carries no potential for chilling advocacy. It merely requires adequate factual investigation prior to assertion of claims. Not surprisingly, all of the cases cited by Alioto which discuss Rule 11's potential

"chilling effects" were decided under the Rule's separate "warranted by existing law" clause.[7]

Second, Alioto argues that the imposition of Rule 11 sanctions wrongfully penalized its corrective action. Alioto Pet. at 19-21. But this case does *not* raise any issue of whether corrective action may limit imposition of Rule 11 sanctions. Alioto simply mischaracterizes the grounds for the award of sanctions by claiming that "the court concluded, *based on the voluntary dismissal*, that the class aspects of the complaint were nonmeritorious when it was filed." *Id.* at 15 (emphasis in original). Sanctions were imposed because of Alioto's failure to conduct a reasonable inquiry before filing the complaint, which resulted in the filing of allegations not "well grounded in fact," not because of the motion for voluntary dismissal (which in any event was for dismissal *without* prejudice). Moreover, as Judge Rymer expressly found, Alioto did not take any corrective action. Its actions were the opposite of corrective, and included: (1) an improper attempt to disengage without cause from class discovery; (2) an improper attempt to dismiss the class allegations without court approval; and (3) an effort to dismiss the class allegations *without* prejudice. App. A3-A5, B3-B7, B9-B10, C1-C3, C5-C6.[8]

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[7]The commentary recognizes that the "well grounded in fact" clause has the potential to chill advocacy *only* if interpreted to require attorneys, prior to filing claims, to research facts that cannot be known without extensive discovery prior to the filing of a complaint. *See, e.g.*, Nelkin, *Sanctions Under Amended Rule 11 — Some "Chilling Problems" in the Struggle Between Compensation and Punishment*, 74 Geo. L. J. 1313, 1339-41 (1986) (cited in Alioto Pet. at 22-23). This case did not impose any such requirement.

[8]Alioto cites two Fifth Circuit cases for the proposition that voluntary dismissals of claims preclude Rule 11 sanctions. Alioto Pet. at 19-20, citing *Thomas v. Capital Securities Services, Inc.*, 812 F.2d 984 (5th Cir. 1987), and *Southern Leasing Partners, Ltd. v. McMullan*,

Finally, Alioto argues that the Rule 11 sanctions will serve their deterrent purpose only if imposed following a warning to the offending lawyer. Alioto Pet. at 20-21. The Rule contains no such requirement.[9] Moreover, this case does not raise the notice issue: with regard to its "well grounded in fact" requirement, the Rule is clear, precise and plainly sufficient to have put Alioto on notice. Sophisticated class action attorneys — like Alioto, App. A12, B5, B8 — should hardly need to be warned that, before filing a major class action complaint, they must take steps to insure that critical shareholder class action allegations are factually accurate with regard to the named class representative, and to investigate, in the face of a clear potential conflict of interest, to insure that a named shareholder class representative is both independent from corporate management and can satisfy the requirements of Rule 23(a). App. A12-A14, B8.[10]

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801 F.2d 783 (5th Cir. 1986). But the cases do not so hold. Rather, they stand for the proposition that the duty to continually review and reevaluate the adequacy of a pleading "*originally supported by an adequate inquiry*" is met if an attorney voluntarily dismisses *with prejudice* what turns out to be a groundless claim. *Thomas*, 812 F.2d at 988-89 (emphasis added); *see also Southern Leasing*, 801 F.2d at 788. In this case, there was no adequate pre-filing inquiry, and Alioto only sought dismissal of the relevant claims without prejudice.

[9]The Advisory Committee Notes to Rule 11 themselves reject any absolute "warning" requirement, leaving the timing of sanctions to the discretion of the district court. "The time when sanctions are to be imposed rests in the discretion of the trial judge." Alioto's reliance on *In re Matter of Yagman*, 796 F.2d 1165, *rehearing denied and amended*, 803 F.2d 1085 (9th Cir. 1986), *see* Alioto Pet. at 20, as establishing a warning requirement is misplaced. *Yagman* recognizes that in cases involving the "well grounded in fact" clause of Rule 11, it may in some circumstances be impractical to require the court to give early notice that sanctions might be imposed. 796 F.2d at 1183.

[10]Nor, as the record reflects, would any warning to Alioto here have had any effect. As the district court found, Alioto persisted in failing

2. There is no conflict among the circuits on any Rule 11 issue in this case.

To justify review, Alioto identifies six purported conflicts among the circuits on Rule 11 issues which, it asserts, are raised by this case. Alioto Pet. at 24-25. All are either illusory or irrelevant to this case, or both.

First, Alioto asserts a conflict in that some circuits ostensibly still apply the "bad faith standard," which governed Rule 11 cases prior to its amendment in 1983, rather than the post-amendment "objective standard." Alioto Pet. at 24. The issue is irrelevant: the Ninth Circuit here applied the proper objective standard. *See* App. A11, B8. And in fact, all circuits now apply that standard. *See, e.g., Eastway Construction Co. v. City of New York*, 762 F.2d 243, 253-54 (2d Cir. 1985) ("*Eastway*"); *Lieb v. Topstone Industries*, 788 F.2d 151, 157 (3d Cir. 1986) ("*Lieb*"); *Stevens v. Lawyers Mutual Liability Insurance Co.*, 789 F.2d 1056, 1060 (4th Cir. 1986) ("*Stevens*"); *Robinson v. National Cash Register*, 808 F.2d 1119, 1127 (5th Cir. 1987) ("*Robinson*"); *Albright*, 788 F.2d at 1221; *Rodgers v. Lincoln Towing Service, Inc.*, 771 F.2d 194, 205 (7th Cir. 1985); *Zaldivar*, 780 F.2d at 829; *Westmoreland*, 770 F.2d at 1177.[11]

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to take corrective action, instead compounding his misconduct. App. A3-A5, B3-B-5, B7, B9-B10, C1-C3, C5-C6. Moreover, Alioto to this day denies any wrongdoing.

[11]The cases cited by Alioto do not demonstrate the contrary. *Suslick v. Rothschild Securities Corp.*, 741 F.2d 1000 (7th Cir. 1984), was decided under the pre-amendment Rule 11. *See Frazier*, 771 F.2d at 265 n.4. In *McLaughlin v. Bradlee*, 602 F. Supp. 1412 (D.D.C. 1985), *aff'd*, 803 F.2d 1197 (D.C. Cir. 1986), the district court opined that the amended version of Rule 11 might not require bad faith, but did not reach the issue because it found that bad faith did exist in that case. 602 F. Supp. at 1417 n.6. As *Westmoreland* indicates, the District of Columbia Circuit now applies the objective standard.

Second, Alioto asserts a conflict with respect to the standard of review in Rule 11 cases. Alioto Pet. at 24. This purported conflict is irrelevant, because (even by Alioto's own account, *id.*) in this case the Ninth Circuit applied the most searching standard of review. App. A11. Moreover, there is no conflict: the circuits apply the same standard of review. *See Robinson*, 808 F.2d at 1126 & nn. 12, 13 (explaining the harmony among the circuits; apparent differences in standards reflect only refinements in the level of analysis).

Third, Alioto asserts a conflict over whether imposition of Rule 11 sanctions is mandatory. Alioto Pet. at 24. There is no conflict: the circuits agree that Rule 11 mandates the imposition of sanctions whenever a violation is found, but allow the district courts substantial discretion to determine the nature and extent of the sanctions. *See, e.g., Eastway*, 762 F.2d at 254 n.7; *Lieb*, 788 F.2d at 157; *Robinson*, 808 F.2d at 1130-31; *Albright*, 788 F.2d at 1222; *Zaldivar*, 780 F.2d at 831; *Westmoreland*, 770 F.2d at 1174. Indeed, the language of Rule 11 unambiguously so requires: "the court . . . shall impose . . . an appropriate sanction."[12]

Fourth, Alioto asserts a conflict over whether Rule 11 warrants imposition of sanctions for attorneys' ethical transgressions. Alioto Pet. at 25. This purported conflict is irrelevant because Alioto was not here sanctioned for violation of ethical obligations. Rather, Alioto was sanctioned for failing so much as to interview Zelezny and, as the Ninth Circuit stated, for violation of its Rule 11 "duty . . . to conduct a reasonable inquiry into whether [it] . . .

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[12]Alioto cites *Lieb* as to the contrary. But as *Lieb* stated: "The use of 'shall' [in amended Rule 11] was deliberate and considered . . . . Although trial judges still retain substantial discretion, its exercise is directed more to the nature and extent of sanctions than to initial imposition." 788 F.2d at 157, citing *Westmoreland*, 770 F.2d at 1174.

should bring the class claims in the face of the potential conflict of interest." App. A14; *see* App. B8. Indeed, the Ninth Circuit's position on this issue is favorable to Alioto: in *Golden Eagle Distributing Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1539 (9th Cir. 1986), *rehearing and rehearing en banc denied*, 809 F.2d 584 (9th Cir. 1987) ("*Golden Eagle*"), the Ninth Circuit held that Rule 11 does not require "courts to enforce ethical standards of advocacy *beyond the terms of the rule itself*" (emphasis added). This case follows that rule. Moreover, there is no conflict: while Alioto cites *Blackwell v. Department of Offender Rehabilitation*, 807 F.2d 914 (11th Cir. 1987), the Eleventh Circuit there did not hold that lawyers may be sanctioned under Rule 11 on the basis of ethical standards drawn from beyond the rule itself.

Fifth, Alioto correctly notes that there may be a conflict on whether Rule 11 imposes a continuing obligation to refine papers originally properly filed in light of new circumstances. Alioto Pet. at 25. *Compare Thomas v. Capital Security Services, Inc.*, 812 F.2d 984, 988 & n.2 (5th Cir. 1987) (there is such an obligation) *with Oliveri v. Thompson*, 803 F.2d 1265, 1274-75 (2d Cir. 1986), *cert. denied*, 107 S.Ct. 1373 (1987) ("*Oliveri*") (there is no such obligation). However, this possible conflict is irrelevant: Rule 11 sanctions were imposed here not based on Alioto's failure to correct a pleading originally filed in compliance with the Rule, but rather on its filing of a complaint which was never in compliance with the Rule.

Finally, Alioto contends there is a conflict on the issue of whether "an attorney can be sanctioned where a *portion* of the pleading is nonfrivolous." Alioto Pet. at 25 (emphasis in original). In fact, the circuits agree that Rule 11 sanctions may be appropriate even if part of a pleading has merit. *Quiros v. Hernandez Colon*, 800 F.2d 1, 2-3 (1st Cir. 1986); *Oliveri*, 803 F.2d at 1280; *Albright*, 788 F.2d at

1220-21. Indeed, Alioto concedes there is no conflict among the circuits, because the only purportedly contrary case it cites, *Golden Eagle*, is from the Ninth Circuit.[13]

Certiorari should be denied on the Rule 11 issue in No. 86-1918.

B. REVIEW SHOULD BE DENIED IN NO. 86-1894 AND NO. 86-1918 BECAUSE THE RULING THAT THE RULE 41(a)(2) CONDITIONS IN THIS CASE ARE NOT APPEALABLE RAISES NO IMPORTANT QUESTIONS OF FEDERAL LAW AND INVOLVES NO CONFLICT AMONG THE CIRCUITS.

The Ninth Circuit's ruling that the Rule 41(a)(2) conditions here are not appealable does not merit review by this Court: it involves no important issues of federal law, and is not a matter on which there is a conflict among the circuits relevant to this case.

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[13]An intra-circuit conflict is not a ground for review by this Court. *See* Rule 17.1. Moreover, in denying petitions for rehearing *en banc* in both this case and in *Golden Eagle* — the purportedly conflicting case cited by Alioto, *see* Alioto Pet. at 25 — the Ninth Circuit properly recognized that the two cases are not in conflict. In *Golden Eagle*, which unlike this case involved the "warranted by existing law" clause of Rule 11, the Ninth Circuit drew a distinction for Rule 11 purposes between pleadings, motions and papers on the one hand, and the arguments supporting pleadings, motions and papers on the other hand. *Golden Eagle* held that Rule 11 permits imposition of sanctions, in the context of motions, only where the motion itself is not warranted by existing law, not where one of the arguments advanced in support of the motion is unwarranted. 801 F.2d at 1540. *Golden Eagle* did not involve, as does this case, the "well grounded in fact" clause of Rule 11; nor does it hold or suggest that Rule 11 sanctions are inappropriate where a portion of a pleading, rather than merely a portion of the supporting argument, is asserted in violation of the Rule. *Id.*

Contrary to petitioners' argument, *see* Alioto Pet. at 27, Barton Pet. at 13, the Rule 41(a)(2) conditions imposed here are neither extraordinary nor unusual. Rule 41(a)(2) provides, in relevant part, that "an action shall not be dismissed at the plaintiff's instance save upon order of the court and *upon such terms and conditions as the court deems proper.*" (Emphasis added.) One condition frequently imposed where, as here, plaintiff seeks a dismissal without prejudice — *i.e.,* where plaintiff seeks to deprive defendant of an adjudication on the merits and preserve its option to sue defendant again — is to condition the dismissal upon plaintiff's payment of the defendant's costs and attorneys' fees. The condition is imposed without regard to plaintiff's or its counsel's good or bad faith, the merits of the pleadings, or any conduct or misconduct of counsel. Fees are awarded to compensate defendants for the work rendered useless by the denial of an opportunity to obtain a favorable adjudication on the merits. *See, e.g., G.A.F. Corp. v. Transamerica Insurance Co.*, 665 F.2d 364, 367 (D.C. Cir. 1981) ("*G.A.F. Corp.*"); *McLaughlin v. Cheshire*, 676 F.2d 855, 856-57 (D.C. Cir. 1982) ("*McLaughlin*"). Plaintiffs against whom such conditions are imposed do not suffer legal prejudice because they are free to pursue their claims in another action or, if they elect not to satisfy the conditions, to withdraw their motion for voluntary dismissal. *See* App. A6-A8; *Lau v. Glendora Unified School District*, 792 F.2d 929, 930-31 (9th Cir. 1986) ("*Lau*"); *G.A.F. Corp.*, 665 F.2d at 367-68.

1. **The ruling that the Rule 41(a)(2) conditions in this case are not appealable does not raise any important questions of federal law.**

Petitioners argue that the Ninth Circuit's non-appealability ruling raises an important issue of federal law — indeed, a due process issue — because they ostensibly

have wrongfully been deprived of appellate review. Alioto Pet. at 27-28; Barton Pet. at 11. This argument ignores the options available to petitioners in the district court: (1) to acquiesce in the conditions by failing to withdraw their motion for voluntary dismissal; (2) to forego the conditions by withdrawing the motion and pursuing their claims; or (3) to withdraw the motion for dismissal without prejudice, take a dismissal with prejudice, and obtain review of the conditions on appeal from the dismissal with prejudice. *See* App. A6-A7; *Lau,* 792 F.2d at 930-31; *Yoffe v. Keller Industries, Inc.*, 580 F.2d 126, 131 n.13 *rehearing denied*, 582 F.2d 982, 983 (5th Cir. 1978), *cert. denied*, 440 U.S. 915 (1979) ("*Yoffe*"). As the Ninth Circuit found, petitioners were "plainly aware of their option to withdraw the motion for voluntary dismissal," yet elected to acquiesce in the conditions by not doing so. App. A7.[14] Moreover, the Ninth Circuit explicitly recognized petitioners' right to seek review by way of a petition for writ of mandamus. App. A10.

Barton also argues that the non-appealability ruling raises an important issue of federal law because, despite the ruling, the Ninth Circuit in fact necessarily determined the propriety of the conditions by affirming the award of Rule 11 sanctions against Alioto. Barton Pet. at 11. This argument simply mischaracterizes the rulings below. The award of Rule 11 sanctions was wholly independent of the Rule 41(a)(2) conditions: whether or not

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[14]As the Ninth Circuit noted: "In their reply memorandum opposing . . . [respondents'] request for [R]ule 41(a)(2) conditions, they [petitioners] explicitly spelled out this option, citing as authority the very District of Columbia case that *Lau* follows." App. A7. Moreover, despite their self-professed reliance on cases ostensibly holding Rule 41(a)(2) conditions appealable, *see* Alioto Pet. at 27, in that very reply memorandum petitioners cited *LeCompte v. Mr. Chip, Inc.*, 528 F.2d 601 (5th Cir. 1976) which stated that Rule 41(a)(2) attorneys' fees conditions are *not* appealable. *Id.* at 603. *See also* note 15 below.

the conditions are valid, Alioto remains obligated to pay the full amount in Rule 11 sanctions. The district court only provided that Alioto's Rule 11 sanctions obligation would be reduced by any payments actually made by petitioners pursuant to the Rule 41(a)(2) conditions to avoid duplicative payments to respondents. *See* App. A5, B11; Barton App. D3.

2. The ruling that the Rule 41(a)(2) conditions in this case are not appealable does not involve a conflict among the circuits.

Petitioners argue that there is a conflict among the circuits on the Rule 41(a)(2) appealability issue. While there is some difference in approach among the circuits as to the mechanism, if any, by which Rule 41(a)(2) attorneys' fees conditions may be reviewed, that difference is one of form, not substance, and moreover is not relevant here. All of the circuits which have considered the issue have concluded that absent a showing of legal prejudice resulting from the conditions — a prerequisite not satisfied by conditions, as here, requiring payment of defendants' fees for work in defending claims which will not be useful if the claims are reasserted — Rule 41(a)(2) conditions are not appealable.[15] App. A10-A11; *Yoffe*, 580 F.2d at 131; *LeCompte v. Mr. Chip, Inc.*, 528 F.2d 601 (5th Cir. 1976); *Scholl v. Felmont Oil Corp.*, 327 F.2d 697 (6th Cir. 1964); *Bowers v. St. Louis Sw. Ry. Co.*, 668 F.2d 369 (8th Cir. 1981), *cert. denied*, 456 U.S. 946 (1982).

It is true that the Fifth Circuit recognizes an exception to this rule by allowing appeals from conditions that a

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[15]Alioto argues that it relied on *G.A.F. Corp.* and *McLaughlin* for the proposition that Rule 41(a)(2) attorneys' fees conditions are appealable. Alioto Pet. at 27. While the District of Columbia Circuit did entertain appeals involving such conditions in those cases, it did not address the appealability issue.

plaintiff pay a defendant's attorneys' fees if the amount of the fees is "clearly" or "patently unreasonable," *and* the plaintiff has not acquiesced in the conditions. *Yoffe*, 580 F.2d at 130-31. But this does not create a conflict: the Ninth Circuit also permits review under these circumstances, through a petition for writ of mandamus. App. A10. No circuit permits review where, as here, the plaintiff has acquiesced in the conditions, App. A6-A7, and the fees condition is not patently unreasonable. App. A10, A16.[16]

Certiorari should be denied in No. 86-1894 and in No. 86-1918 as to the Rule 41(a)(2) non-appealability issue.

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[16]Contrary to petitioners' assertions, the Rule 41(a)(2) conditions here were in no sense patently unreasonable. As the Ninth Circuit found, the admittedly substantial fees incurred by respondents must be viewed in light of the massive liability threatened by plaintiffs' class action complaint. App. A16. Moreover, the district court set the amount of fees only after lengthy proceedings and formal findings by the magistrate. App. A5, B10-B11; Barton App. D1-D4; *see also* App. A16. Fees were awarded *only* for respondents' costs of defending against the claims which were dismissed without prejudice — the class action claims — and not for respondents' work in securing imposition of the conditions or in documenting the amount of fees to be awarded. App. B6, B11. *See also* note 6 above. Alioto's argument that the district court improperly awarded fees for defense work which would prove useful in respondents' defense of Unioil's and Richards' remaining individual claims (Alioto Pet. at 27-28) is not only unsupported by the record, but deliberately neglects to advise this Court that Unioil's and Richards' remaining claims were dismissed with prejudice for failure to prosecute. App. A5.

CONCLUSION

For the foregoing reasons, respondents respectfully request that the Petitions for Writs of Certiorari in No. 86-1918 and No. 86-1894 be denied.

Dated: July 24, 1987

Respectfully submitted,

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PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On July 24, 1987, I served the within BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI in re: "Alioto & Alioto vs E. F. Hutton & Co., Inc." in the United States Supreme Court, October Term 1987, Nos. 86-1918 and 86-1894;

On the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

CLERK, UNITED STATES
COURT OF APPEALS
NINTH JUDICIAL CIRCUIT
Seventh & Mission Streets
P. O. Box 547
San Francisco, California 94101

CLERK, UNITED STATES
DISTRICT COURT,
CENTRAL DISTRICT OF
CALIFORNIA for the
Hon. Pamela A. Rymer
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All Parties required to be served have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on July 24, 1987, at Los Angeles, California

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Supreme Court, U.S.
FILED
AUG 28 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-~~1918~~

In The

Supreme Court of the United States

October Term, 1986

Alioto & Alioto; Heck & Heck, Inc.; Heck Oil, Inc.; and Mark Zelezny,

Petitioners,

v.

E. F. Hutton & Co., Inc.; Kurt Feshbach; Stockbridge Partners, Inc.; Richard Jacoby; Haim Pekelis; Shearson-American Express, Inc.; Oppenheimer & Co., Inc.; and Donaldson, Lufkin and Jenrette Securities Corporation,

Respondents.

REPLY BRIEF OF PETITIONERS ALIOTO & ALIOTO; HECK & HECK, INC.; HECK OIL, INC.; AND MARK ZELEZNY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Joseph, "The Trouble With Rule 11," 73 *A.B.A. J.* 87 (August, 1987) 3

To the Honorable William H. Rehnquist, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

Petitioners, Alioto & Alioto; Heck & Heck, Inc.; Heck Oil, Inc.; and Mark Zelezny, hereby reply to the Joint and Consolidated Brief of Respondents in opposition to their petition for writ of certiorari as follows:

I

RESPONDENTS FAIL TO ADDRESS THE PRINCIPAL ISSUE RAISED BY THE RULE 11 AWARD: THAT THE ACTION FILED WAS NEVER FOUND FRIVOLOUS BY EITHER THE DISTRICT COURT OR THE APPELLATE COURT.

Respondents spend considerable time and energy in their opposition to petitioners' briefs in disputing issues which are not raised in those briefs, in an apparent attempt to disguise the real questions before this Court.[1] Neither petitioner Barton nor these petitioners dispute that an award may be made under Rule 11 if the court finds the pleading at issue not "well grounded in fact" (as opposed to "not warranted by existing law"), or that the district court made "findings of fact" in awarding the sanctions against petitioner Alioto. (Respondents' Brief ("R.B.") at pp. 3, 15-16.) Petitioners do not, however, as respondents suggest, seek review by this Court of the *facts* underlying the Rule 11 award. Petitioners seek review of the Ninth Circuit's *legal conclusion* that the conduct sanctioned constituted a violation of Rule 11 in the absence of a finding by either lower court that the action was not well grounded in fact.

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[1] Respondents also engage in impermissible and unsupported speculation about petitioners' motivations for filing the complaint, which this Court should ignore. (Respondents' Brief ("R.B.") pp. 3-4; *see also* Barton Reply Brief, pp. 2-3)

In this case, nearly $300,000 in Rule 11 sanctions were awarded (and affirmed) against an attorney, without warning, after only two months of actual litigation on the case itself, and before any motions to dismiss were heard or motions for class certification or summary judgment were brought, for filing a complaint whose *substantive allegations were never challenged, although they were the same as to all the named plaintiffs.* The case had barely begun when the court awarded the sanctions, and none of the procedural mechanisms available under the Federal Rules had been used to refine the pleading, narrow the issues, or make determinations on the merits of the lawsuit filed. The district court, itself, repeatedly stated that the sanctions did not go to the merits of the substantive allegations in the complaint. (Petitioners' Brief ("Alioto Brief"), p. 14.)

Instead, the sanctions were awarded because the district court disagreed with petitioner Alioto's choice of party plaintiffs and because petitioner filed the lawsuit on behalf of all those damaged by the conspiracy without talking personally to one of the class plaintiffs, and despite insinuations in a newspaper article that other Unioil shareholders were "unhappy" with the company. Based on petitioner Alioto's failure to reach the same *legal* conclusion as the Court as to the propriety of the named plaintiffs, the Court found he had not performed a reasonable inquiry into the facts underlying the class claims. The primary issue before this Court, an issue which respondents simply ignore in their opposition, is whether such conduct is sanctionable under Rule 11 where the factual and legal basis for the substantive allegations as to all the parties, including the class, are never found by either of the lower courts to be without merit.

Contrary to respondents' blithe assertion, the law is not "well settled" in the federal courts with regard to the "well-grounded-in-fact" requirement of Rule 11. (R.B. at pp. 15, 20-23.)[2] In the four years since the Rule was amended in August 1983, commentators throughout the legal community have expressed deepening and increasing concern about the continued uncertainty surrounding the Rule's application by the federal courts. In the most recent article to come to petitioners' attention, Gregory P. Joseph observed that the disagreement among federal judges on "precisely what conduct constitutes a violation" renders practice under the Rule like "negotiating a mine field. You know there will be an explosion if you step on a mine. The trouble is, you don't know where the mines are." Joseph, "The Trouble With Rule 11—Uncertain Standards and Mandatory Sanctions," *A.B.A. Journal* 87, 89, August, 1987.

Although *some* uncertainty about what conduct is sanctionable under Rule 11 may be inevitable, because each case will rest on its own facts and legal theories, it seems at a minimum the Rule requires courts to make a determination on the merits of the pleading in question before sanctions are appropriate. It is critical to this case that neither the district court nor the appellate court took issue with the substantive conspiracy allegations in the complaint filed against the respondent brokers. No one, including respondents, disputes that *both* Unioil and its shareholders would be damaged by a concerted scheme

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[2] Respondents mischaracterize the abbreviated survey petitioners offered the Court in their brief. Petitioners do not pretend that every conflict or inconsistency demonstrated by the cases cited is "raised by this case." (R.B. at p. 20.) The cases are cited to illustrate the nationwide confusion about Rule 11 and to demonstrate that, because this case is typical of that confusion, this Court should grant a writ of certiorari to review a federal question of national importance.

to depress the price of Unioil's stock if such a conspiracy were proven.

Rule 11 is designed to deter the filing of meritless lawsuits. No finding was ever made that the allegations in the complaint were meritless as to *any* plaintiff, including the class. All that the court found was that Mark Zelezny, the only class plaintiff "with an appearance of independence from Unoil," could not adequately represent the shareholder class because, in the court's opinion, his experience was different from that complained of in the complaint. As discussed in the Alioto Brief, based on the factual information he reviewed and his theory of the case, Mr. Alioto concluded that both Mr. Zelezny and the Heck Companies were proper class plaintiffs, absent a showing that they themselves participated in the conspiracy.[3] (Alioto Brief, pp. 16-17.)

The court's contrary conclusion in this regard does not render the complaint and its substantive allegations meritless and should not have been the basis of a sanctions award. Even if, after a full briefing on the class certification issues, Mr. Zelezny was still found to be an insufficient class plaintiff, sanctions would be indicated *only* if Mr. Alioto had *no* reasonable basis for including him. Indeed, where a class plaintiff is mistakenly included, the remedies are numerous under the Federal Rules. Another class plaintiff could be substituted, the class could be decertified, or other nonpunitive measures could be used to remedy the situation. Where a meritori-

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[3] In the context of a fraud-on-the-market case, Mr. Zelezny's deposition testimony that he thought Unioil was trading at a fair price only *supports* his reliance on the integrity of the market. In addition, contrary to respondent's insistence that he bought Unioil stock in the face of the voluminous shortselling, respondents simply disregard the fact that Mr. Zelezny also *sold* his stock at a tremendous loss when the scheme to depress the stock succeeded.

ous action has been filed, the fact that parties may later have to be realigned or substituted does not warrant sanctions under Rule 11. The law is not black and white, and differing interpretations are the law's lifeblood. Where the court awards sanctions based on its disagreement with counsel's legal analysis about whom he can include in the suit, the chilling effect of such an application of the Rule is manifest.

The same is true with regard to the shareholder lawsuits filed *after* the complaint at issue, which raised a question about the continued representation by counsel of some of the parties. The fact that the later shareholder actions posited a *different* legal theory for the decline of Unioil's stock does not reflect on the merits of the action against the brokers. Alternative and even inconsistent theories of liability are commonly pursued in the federal courts in the same action, under Rule 8. In this case, the fact that a new theory was alleged in a *different* action does not make the theory in the original action erroneous. The time for determining which theory was correct was at the conclusion of the cases, not on a motion to dismiss voluntarily on procedural grounds only two months after the pleading was filed. Indeed, no actual conflict ever existed, and the potential conflict of interest was resolved by substituting new counsel for Unioil and Richards, a commonplace procedure for dealing with such a situation. Moreover, *respondents* were not prejudiced in any way by the fact that the potential conflict which arose later required the substitution of new counsel for some of the parties.

Furthermore, the Ninth Circuit's affirmance of the sanctions in this case operates to discourage attorneys from taking prompt corrective action once a circumstance arises which indicates claims should be withdrawn. In-

deed, the district court implied that sanctions were not appropriate where plaintiffs dismissed their "representative claims once it appeared appropriate to do so" (when the shareholder actions were filed) (App. B-6), and where they had "simply withdraw[n] claims, if they legitimately believed the class aspects of the complaint were well grounded in fact." (App. B-9.) As petitioners, in fact, withdrew their claims when it appeared appropriate to do so, one is hard-pressed to understand the court's self-contradictory Rule 11 award. It is noteworthy that Richards and Unioil escaped the district court's sanctions by withdrawing from the motion for voluntary dismissal through new counsel and simply allowing their claims to lie fallow. Ironically, Alioto was punished for initiating prompt corrective action.[4]

In the final analysis, the Ninth Circuit, in affirming the district court's Rule 11 award, has created a new "prong" to the Rule—the reasonable inquiry prong—which the district courts may now apply in isolation and without regard to the merits of the pleading at issue. By approving the award without regard to the merits of the lawsuit, the Ninth Circuit's decision in this case could lead to the chilling result that courts could sanction an attorney who files a *meritorious action* simply because the court finds fault with the attorney's prefiling investigation. As the Rule's purpose is to conserve judicial resources by deterring the filing of groundless actions, to

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[4] Contrary to respondents' contention, there was nothing improper about petitioners' seeking dismissal *without* prejudice and neither the district court nor the Ninth Circuit so held. (R.B. at p. 18) Moreover petitioner's purported "improper attempt to disengage without cause from class discovery" was *not* an issue in this case because that dispute was resolved in an earlier proceeding before the U.S. Magistrate. (App. B-3, para. 11.) Respondents' reference to the proceeding is a barefaced attempt to prejudice this Court.

allow the Ninth Circuit's expanded application in this case could lead to an "Orwellian" interference by the courts in every exercise of an attorney's professional judgment. As demonstrated by the authorities offered to the court by petitioners, uncertainty about what conduct may subject attorneys to sanctions is rampant nationwide. Where attorneys cannot predict when the sanctioning power of the federal courts will be wielded against them, their effectiveness as advocates, and advocacy itself is irreparably damaged. Rule 11 serves a good and useful purpose only if its application is confined to punishing abuses of the judicial process by the filing of baseless claims. The Rule in this case was not applied to conduct governed by it and, in fact, worked to prolong the litigation and increase the burdens on the judicial system. Petitioners respectfully request this Court to review the sanctions awarded in this case and to set forth guidelines regarding Rule 11's application by the courts in the future.

II

RESPONDENTS IGNORE THE LEGAL PREJUDICE SUFFERED BY ALL PETITIONERS DUE TO THE NINTH CIRCUIT'S HOLDING FOR THE FIRST TIME THAT THE RULE 41(a)(2) AWARD WAS NOT APPEALABLE.

Despite the clear fact that petitioners were effectively denied *any* review of the reasonableness of the Rule 41(a)(2) award of nearly $165,000 for only two months of litigation, respondents assert that "no important issues of federal law" are implicated by the Ninth Circuit's holding *for the first time* that such an award is not reviewable on appeal. In taking such a position, respondents simply ignore that the holding amounts to a denial of due process. The Ninth Circuit's observation that review might be obtained on a writ of mandamus is cold

comfort to appellants who have already undertaken the expenditure of time and money on an appeal, and where the court from whom they must seek the writ has impliedly approved the award. Moreover, as petitioner Barton cogently argues in his petition and reply, to limit appellate review solely to a writ proceeding could easily lead to unjust and inconsistent results due to the differing status of the parties involved. Even were plaintiff petitioners able to obtain review of the Rule 41(a)(2) award in a writ proceeding, and were they able to obtain a reversal or reduction of the award, petitioner Alioto would be prejudiced because the Rule 11 award, in which the Rule 41(a)(2) award is subsumed, is final as to him.

Nor, as respondents repeatedly assert, did petitioners "acquiesce" to the Rule 41(a)(2) award in light of their immediate appeal of the award. (Alioto Brief, pp. 27-28.) Indeed, the logic of the Ninth Circuit's holding in this case that a failure by a party against whom a Rule 41(a)(2) award is made to withdraw the motion for voluntary dismissal is deemed "acquiescence" to the award is questionable. (App. A-8.). Withdrawal from the request for voluntary dismissal was impossible in this case, even in the face of an outrageous and burdensome condition to dismissal, due to the district court's ruling that petitioner plaintiffs were inappropriate class representatives. Indeed, the Ninth Circuit's holding that failure to withdraw from a motion for voluntary dismissal is henceforth deemed acceptance of the conditions in that circuit, sets up a presumption that would make review of the reasonableness of the award nearly impossible to obtain even in a writ proceeding. Certainly the Ninth Circuit's retroactive application of its new holding redounds to the prejudice of all the petitioners.

Moreover, dismissal with prejudice was not a viable "option," as respondents contend, where the dismissal sought is based on the *form* of the litigation, rather than on the merits. To force plaintiffs to give up important legal rights to obtain review of the award on appeal, is a drastic requirement which should be imposed sparingly, if at all.

Similarly, respondents' contention that there is no conflict among the circuits with regard to the appealability of the reasonableness of a Rule 41(a)(2) award is clearly belied by the cases cited by petitioners. There is clearly a split of authority among the circuits as to whether attorneys' fees and costs awarded under Rule 41(a)(2) constitute sufficient legal prejudice to be appealable. While the Ninth Circuit held for the first time in the *Unioil* case they are not, the District of Columbia and Fifth Circuits have held they are. (Alioto Brief, pp. 27-28.) Given the due process implications of the Ninth Circuit's decision in *Unioil* as to petitioners, the conflict among the circuits should, by itself, be sufficient reason for this Court to review the issue.

The fact that the Ninth Circuit impliedly upheld the reasonableness of the Rule 41(a)(2) award in upholding the Rule 11 award raises additional problems because different factors are taken into account in making awards under Rule 11 and Rule 41(a)(2). Under 41(a)(2), only those fees and costs which were incurred for work which would *not be useful* in succeeding litigation should be awarded. In this case, contrary to respondents' contention, at the time the award was made, Unioil and M. L. Richards indicated to the district court their intention to file new pleadings and to pursue their claims against the brokers. (App. B-9.) Thus, at the time the award was made, the usefulness of the work done up to that point

should have been but was not considered. The fact that Unioil and Richards would not subsequently prosecute their claims was not known when the award was made. The award should have been made and should be accorded appellate review in light of the circumstances known at that time, not in light of events which unfolded later.

Finally, respondents' statement that the Rule 41(a)(2) award was made "without regard to plaintiff's or its counsel's good or bad faith, the merits of the pleadings, or any conduct or misconduct of counsel," is simply untrue. (Resp. Brief, at p. 24, citing *G.A.F. v. Transamerica Insurance Co.*, 665 F.2d 364, 367 (D.C. Cir. 1981) and *McLaughlin v. Cheshire*, 676 F.2d 855 (D.C. Cir. 1982).) Both lower courts clearly took these factors into consideration in awarding and affirming the entire amount of the awards under both Rules against petitioner Alioto. Under the rule in *G.A.F.* and *McLaughlin* this was an impermissible use of Rule 41(a)(2) and should be reversed on that ground, alone.

—o—

CONCLUSION

For the reasons set forth in all the petitioners' briefs, these petitioners respectfully request this Court to grant their petition for a writ of ceritorari in this case.

DATED: August 27, 1987

Respectfully submitted,

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